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***(The opinions expressed in articles in The Canadian Chartered Accountant are the opinions of the writers of the articles and are not necessarily endorsed by the Association.)***

## Editorial Comment

(Contributed)

*Audit Reports For Credit Purposes*

The New York Credit Men's Association published some time ago a pamphlet entitled "Financial Statements—Minimum Requirements for Credit Purposes" which stated the viewpoint of the credit guarantor and reproduced correspondence which had passed between it and the New York State Society of Certified Public Accountants. The attitude of the Association broadly is that while a short form of audit report such as that contained in "Extensions of Audit Procedure" may suffice for the ordinary shareholder of a corporation it is inadequate for the purpose of the credit man who, as an analyst, requires a detailed statement by the accountants of the work done in connection with the audit. "The soundness of his [the credit man's] judgment is vitally affected by factual information in connection with audit procedure: he cannot accept a blanket expression of opinion." Particularly, so far as balance sheet items are concerned, he wants to know the scope of examination made of cash, receivables, inventories, notes and trade acceptances pay-

able, other notes and accounts payable, accrued expenses and contingent liabilities.

A Committee of the New York State Society of Certified Public Accountants expressed the opinion that the practical solution would be for the client to authorize the auditor to append to the financial statements to be submitted to credit granters "a report which would outline the general scope of the examination made of each of the important balance sheet items and of the income and surplus statements when the latter statements are a part of the report."

Obviously nothing but good can come of close co-operation between accountants and credit men and if the credit men say they want certain audit information which is not contained in the "general purpose" audit report the accountant can do no harm by enquiring whether his client is agreeable that this additional information should be provided. We confess however to being somewhat sceptical of the competence of the credit man *as such* to base a judgment on "factual information in connection with audit procedure." Auditing after all is a highly technical profession and the only person who is qualified to form an opinion on the adequacy, in any given circumstances, of any given audit procedure, is one who is a master of the auditing technique. The individual credit man may of course possess such a mastery but professionally he is a credit man and not an auditor.

We take the stand that, if a professional auditor forms and expresses an opinion on a financial statement or on a particular item in such a statement, that is the best *kind* of opinion or judgment that can be secured. If for example a public accountant stakes his professional reputation on the opinion that the "cash on hand is $500.00" no useful purpose is served by the laity in enquiring what work the accountant did in arriving at that opinion. That information constitutes only one of a set of two variables—the other being the precise system of accounting and internal control, etc., in operation in the client's office. The only useful line of further enquiry by the outsider would be an investigation into the professional reputation of the individual accountant, because in the end reliance must be placed on the auditor's own judgment as to the necessary audit procedure.

*Clothes Rationing*

The stocks of clothing and footwear in Great Britain had by the early part of this summer fallen so far below normal that the government introduced a system of ration coupons for the retail purchase of the commodities. Apparently the initial ration represented the average normal consumption per head of population and so did not, as a mathematical proposition, effect a reduction in the aggregate demand. Practically the demand is likely to be sharply reduced because on the one hand those who normally bought clothing in excess of the coupon allowance will now be restricted to the ration, and on the other hand those who normally bought less than the rationed quantity are unlikely to bring their consumption up to that level since there is no inducement for them to do so. That the authorities are assuming a very substantial saving of this sort is apparent from the estimate of the Board of Trade that if everyone made full use of his ration coupons current production would have to be expanded instead of contracted in the clothing and footwear industries.

The steps so far taken will prevent the hoarding of clothing (that is, purchase in excess of current needs) by the richer members of the community and will result in the retention of supplies intended for the poorer members. Quantity rationing by itself however is not enough, in the face of a progressive shortage, to ensure an even distribution between rich and poor, for the existence of a supply intended for the poor is no protection to them unless it is offered for sale at prices within their means. For the moment, the quantity rationing may ease the pressure on price but it can be only for the moment. It is to be anticipated therefore that at some future date the ration plan will be supplemented by a system of price control.

*The Lighter Side*

Viewed from the lighter side clothes rationing has its humour. One curious effect has been to release from the moth balls and restore to active service those garments of men's formal day wear, such as morning coats and silk hats, which were discarded when men last struck a blow for sartorial freedom and won the right to be comfortable until dinner time. We suspect that there is a sufficient reserve stock of these articles and in a state of perfect preservation to keep the business and professional men of Great

Britain decently, if not comfortably, attired for the duration of the war.

Another effect of clothes rationing has been to give a certificate of respectability to those innumerable articles of men's everyday wear which had been recently condemned by the women folk as no longer "fit to be seen." So with tactfully suppressed glee and even with a shameless air of hypocritical virtue men are once more sporting on the street those friendly and comfortable suits, hats, etc., which though still "perfectly good" (in the opinion of their owners) had been relegated to garden wear from the spring of 1939 on. It seems to us that our preponderantly male legislatures should take advantage of existing circumstances to introduce a measure of clothes rationing for Canada ostensibly in the cause of national defence, but actually to make it domestically feasible for us to continue to wear our comfortable old clothes.

*Secondary Effects of Rationing*

Every extension of the list of rationed and price-controlled commodities in an economy increases the purchasing power directed by frustrated consumers (that is to say, consumers who had normally purchased in excess of the ration quantities) to the diminishing list of non-rationed commodities. This ever-increasing pressure on the non-rationed commodities is bound to result in immediate price inflation and early exhaustion of supplies, and to lead eventually to a situation in which incomes in excess of a certain amount will become unspendable except upon those goods—and more particularly those services—the production of which can be continued or even expanded without any diversion of human or material resources from war needs.

Already in Great Britain there can be discerned the beginnings of that boom in services, such as theatres and education, which always follows extensive rationing of goods. In Germany for some time past many people are said to have been compelled to lend part of their incomes to government because it is quite impossible for them to spend it. This presumably means that the German application of resources to war needs has been so thorough and ruthless that even the resources normally employed in art and education have been diverted to the needs of the war machine.

*The Press under Nazi Control*

In the raid on the Lofoten Islands early this year a large number of military documents were captured at the military Harbour Control Post at Svolvaer, and, among them, instructions for the control of the Norwegian press. These instructions fall under seventeen copious heads the first of which by itself indicates sufficiently the prostitution to which the Norwegian press has been subjected and the error of confusing the German vaporizings with the free voice of the Norwegian people. "The foremost task of the press is to be an instrument of political leadership. It must consequently publish only such news as is designed to further, or at least not to hinder, the policy of the German Reich and those measures taken by Norwegian authorities instrumental in its execution." Following the recital of the formal instructions is a warning to the army officers amongst whom the report is circulated: "The above outlines should form the subject of intensive oral instructions to editors. In no circumstances must these instructions be made public, nor must the fact that such instructions have been given to editors became known in any way. Editors should, however, make notes while they are receiving oral instructions."

It would be a salutary if a somewhat grim business to concoct an issue of this magazine on the supposition that Hitler's "New Order" had been established in Canada, and that the Editor had made and digested the appropriate "notes while he was receiving oral instruction." Such an issue would give us a lively understanding of at least one aspect of Hitlerism.

# DOUBLE TAXATION OF INHERITANCES IN CANADA

By William H. Wynne,[1]
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ALTHOUGH the term "double taxation" is commonly used as one of opprobrium, taxation of the same thing or person twice over by different jurisdictions (or by the same jurisdiction) is not necessarily unjust. So long as all similarly situated taxpayers are taxed equally, there is, for example, nothing inherently unfair in the levying of an income tax or an inheritance tax by both federal and state governments. Duplicate taxation becomes inequitable only when it involves the taxation of some members of a class once, while other members of substantially the same class are taxed more than once. To the extent that no such discrimination arises, duplicate taxation may be uneconomical, but it will not be unjust. While tax duplication is present in Canada in a number of forms—though the varieties are appreciably fewer than in the United States—there is relatively little discriminatory double taxation outside the field of death taxes. But in death taxes—unlike the situation in the United States where the evil has been largely eliminated—double or multiple taxation is still prevalent in Canada despite a long history of attempts by various means to effect a remedy.

Commencing with a brief description of the Canadian death tax system and an explanation of the circumstances which give rise to double taxation under it, this article shows in what directions and with what results a remedy

[1]*Editor's Note:* Dr. Wynne was born in London, England, and received his school education there. He is a graduate of Queen's University, Kingston, (M.A. 1920), and of Cambridge University (Ph.D. 1926) and is a barrister-at-law of Gray's Inn. During 1937-38 he was a member of the research staff of the Royal Commission on Dominion-Provincial Relations. This paper is based upon a study made by him for the Commission and was prepared for and published by *The Bulletin of the National Tax Association* (January 1941), to which we make grateful acknowledgment. The subject of taxation of inheritances is now of even greater interest in Canada since the Dominion Parliament at its last session passed *An Act to Authorize the Levying of Duties in Respect of Successions*, which was given Royal assent on 14th June 1941. Dr. Wynne is at present on the staff of the University of Michigan, Ann Arbor, Michigan, but is also carrying on considerable economic research at Washington, D.C.

for the double death tax problem has so far been sought, and concludes by presenting what appears to be the only effective solution.

## Pattern of Canadian Death Taxes

Modern death taxes take two principal forms—a tax levied on the whole corpus of an estate, and a tax levied on the shares passing to beneficiaries. The former is commonly termed an estate tax, and the latter variously a succession duty,[2] legacy duty, or inheritance tax. Great Britain employs both, but derives the bulk of its death tax revenue from the estate tax. In the United States the federal government imposes an estate tax, while the states for the most part use the inheritance tax; a few states impose both types of tax. In Canada the Dominion government has not entered the field of death taxes,[2a] and they are imposed by the provinces only. All nine provinces levy a tax which is a hybrid of an estate duty and a succession duty. No tax is in fact levied on the total value of the decedent's estate, but rates of duty based on it are applied to the shares of the beneficiaries. Until 1905 this hybrid form of death tax, which is in essence an estate duty, was alone employed, but in that year Ontario added a true succession duty levied on the share received by the beneficiary at a rate governed by the size of the share and not by the size of the whole estate. Other provinces followed Ontario's lead, and down to the close of the last World War this system of compound death taxes was maintained, except in Prince Edward Island, throughout the Dominion. British Columbia in 1921 and Manitoba in 1923 abandoned the supplementary true succession duty; in 1933, however, the former restored the levy and today the only provinces not employing it are Manitoba and Prince Edward Island. These two provinces, then, confine their death taxation to a tax on inheritances based on the size of the estate. The other seven provinces also levy such an estate-based tax, but add to it a tax based on the size of the inheritance.[3]

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[2]In Canada the term "succession duty" is used almost exclusively.

[2a]This is no longer so. A Dominion succession duty was proposed in the budget presented on 29th April 1941 and enacted one month later.

[3]The new Dominion duty is similary composite in form. Both the estate-based tax and the share-based tax discriminate in favour of near relations as against more distant relatives and strangers. The more remote the relationship of the beneficiary to the decedent, the

### How Double Taxation Arises

By section 92 of the *British North America Act* (the Canadian constitution) a provincial tax to be valid must be "within the province."[4] This limitation has been construed by the courts to mean only that the subject matter of the tax must be within the province. Provincial succession duty statutes have accordingly been framed so as to make the subject matter of taxation sometimes the property of the decedent, sometimes the transmission of shares in the estate to beneficiaries, and sometimes both;[5] and it is out of this duality of subject matter that double taxation has arisen. To the extent that a succession duty takes the form of a levy on property, it is clear that the tax is *intra vires* only of the province where the property has its situs. So far as real property is concerned, no contrary views have ever obtained, and no province has presumed to impose a death tax on real property outside its borders. Nor has any province sought to tax the transmission of such real property to a resident beneficiary. Furthermore, at least since the decision of the Privy Council in 1908 in the case of *Woodruff* v. *Attorney-General of Ontario*,[6] it has been recognized that it is beyond the competence of a province to impose a succession duty in respect of personal property situated elsewhere when the subject matter of the duty is the property and not its transmission. But the *Woodruff* case did not invalidate the assumption of the provincial authorities that, so long as the tax was made on the transmission of a succession to the property of a resident decedent, they could, of right, levy a succession duty even in respect of the extra-provincial personal property in the decedent's estate, a right they deduced from the old and well-known maxim, *mobilia sequuntur personam* ("movable property follows its owner"). Applicable though the maxim is to tangible as well as to intangible personal property, it seems to have been invoked

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heavier the rate at which a bequest is taxed and the lower the amount exempted. Such justifiable discrimination is, of course, an almost universal feature of death taxation.

[4]The tax must, in addition, be "direct."

[5]The subject matter of a succession duty might also be the beneficiary himself. But no province appears to have framed its succession duty statute so as to impose a direct tax upon beneficiaries resident within the province, though it could probably validly do so even when the property to which they succeed is situated elsewhere.

[6](1908) A.C. 508.

by the provinces chiefly, if not solely, in connection with intangible property. Double taxation as it has arisen in Canada out of provincial succession duty legislation has thus taken mainly the form of a tax levied on the intangible property in an estate by province A in which that property has its situs, added to a tax levied on the transmission of the property by province B in which the decedent died domiciled. Since the tax imposed by each province is based on the total value of the decendent's estate, double taxation may swell considerably the duties payable on it, with the result that some estates and some inheritances may be taxed much more heavily than others of equivalent size, where the only difference in conditions lies in the composition of the property affected.

Intangible property is essentially the evidence of a debt, that is, of a mere relation between parties. Having consequently no location in fact, only in a legal sense may such property be said to possess a situs. As to where that situs shall, for succession duty purposes, be deemed to be, common law rules constitute, in most instances, the governing authority. Thus, a simple contract debt, being enforceable in the jurisdiction wherein the debtor resides, is deemed to have its situs there. Specialty debts, that is, debts evidenced by an instrument under seal, the courts have ruled, have their situs in the place where the instrument is found at the time of the owner's death. The situs of bonds, whether specialties or not, is similarly determined. Shares of capital stock, it has been held, have their situs where they can be effectively dealt with, or, in other words, where the company has its transfer agency. A company may, however, maintain a number of such agencies. In that event, the situs of shares in the company is determined "by the place where the share certificates are found at the time of the death of the deceased owner, if there is a register in that place."[7] Bank deposits are regarded as having their situs at the location of the bank office or branch in which they are on deposit. To take only one more form of intangible property, the situs of the debt represented by a life insurance policy, i.e., the place where payment is to be made, may be considered. For the determination of the situs of such a debt it is usually unnecessary to rely upon

[7]S. Quigg, "The Law Relating to Succession Duties in Canada," 2d ed., Toronto, 1937, p. 176.

common law rules, for the situation is fairly completely covered by statute. Under the uniform life insurance acts enacted by all provinces except Quebec between 1924 and 1926, insurance moneys were in effect made payable in the province in which the insured was resident at the time the policy was taken out. But by amendments to these uniform acts passed by the eight provinces in 1935 or 1936, the situs of the debt was changed to the province of domicile at the time of death, or, failing such province, to the province in which the Canadian head office is located. Quebec has, since 1908 or earlier, provided by its insurance act, without amendment, that any policy insuring a person domiciled or resident in that province shall, practically speaking, be deemed to be payable there.[8]

If all the provinces confined themselves to taxation on the basis of either the domicile of a decedent or the situs of his property, there would, of course, be no double death duties within Canada. Manitoba, from 1910 to 1923, and Alberta, until 1927, did indeed levy succession duty only on property within the province (though at a rate based on the value of the entire estate), but as the need for revenue became greater they ceased to restrict themselves to a situs-based tax and began, like the remaining provinces, to combine the principles of domicile and situs. Even without uniform legislation providing for the levying of death taxes on the same single basis—either domicile or situs—double taxation under Canadian succession duty acts could be avoided by reciprocal agreements among the provinces, providing either for the exemption from taxation by each party of intangible personalty belonging to a decedent domiciled in the other, or for the allowance by the province of the decedent's domicile, as a deduction from the tax assessed by it on a succession, of any duty charged on the same succession by another province.

To what extent, and with what success, have attempts been made in Canada to alleviate the hardships of double death duties by either uniform legislation or reciprocal agreements?

### Failure to Cope with Double Taxation by Means of Uniform Provincial Legislation

So far as uniform legislation is concerned there has unfortunately been no advance beyond the discussion stage.

At the meeting of the Canadian Bar Association in 1922, the Nova Scotia commissioners to the Conference on Uniform Legislation in Canada[9] were instructed to prepare for discussion a draft succession duty act based upon situs. After careful consideration the commissioners recommended, in the report which they submitted in the following year, that the Alberta act was a suitable one to be used as the basis of discussion.

A more important step was taken in August 1925 when, at the suggestion of Premier Bracken of Manitoba, an Inter-provincial Conference on Succession Duties was held in Winnipeg, at which representatives of Ontario and the four Western Provinces (but not of Quebec or the Maritimes) were present. A resolution was passed calling for the appointment of a committee to prepare, for submission to a further inter-provincial conference, a draft uniform act along given lines, or, alternately, a draft inter-provincial agreement providing for the allocation of personalty for death duty purposes between the province of its situs and the province of the decedent's domicile "with a view to an equitable distribution between the provinces for purposes of taxation." The proposed draft uniform act was to substitute for existing death duties a probate or estate duty leviable at a rate based on the aggregate value of the estate but applicable only to property (real and personal) actually situated within the province, together with a succession duty at a rate based on the beneficiary's individual share and his relation to the decedent. Double taxation in connection with this latter succession duty payment was to be

[8]The relevant section of the Quebec statute (1925 R.S.Q., c. 243, s. 213) is worded as follows:

"When the subject matter of any insurance contract is . . . in connection with a person domiciled or resident (in the Province) any policy (etc.) evidencing the contract shall, if signed, countersigned, issued or delivered in the Province or committed to the post-office (etc.) to be delivered or handed over to the insured, his representative or agent in the Province, be deemed to evidence a contract made in the Province, and all moneys payable under the contract shall be payable . . . in the Province. This section shall have effect notwithstanding any agreement, condition, or stipulation to the contrary."

[9]The Conference of Commissioners on Uniformity of Legislation in Canada is a body stemming from the Canadian Bar Association. The commissioners sit from year to year just prior to the annual meeting of the Canadian Bar Association and submit their reports to the parent body. These reports are printed as an appendix in each Annual Report of the Bar Association.

prevented by taxing successions to real estate on the basis of situs and successions to personalty on the basis of the decedent's domicile.[10]

Drafts of a uniform act and of a proposed agreement were accordingly prepared and submitted to an inter-provincial conference convened in Ottawa in June 1926, but without successful outcome. No records of the discussion appear to have been kept; it is, however, reasonably certain that among the obstacles which could not be surmounted was the attitude of Ontario which at this time showed a preference for seeking a separate agreement—never in fact arrived at—with Quebec.[11] That this was not the only difficulty became manifest a few months later when a smaller conference confined to the four western provinces and promoted by them for the purpose of effecting a solution of the problem of double taxation as among themselves failed to accomplish anything.[12] There is no evidence that there have been since then any further attempts to promote, by inter-provincial conferences or otherwise, uniform legislation designed to put an end to duplication in death duties.

### History of Reciprocal Agreements

More tangible results were, for a time, achieved by means of reciprocal agreements, in accordance with which the province of the decedent's domicile allowed to be offset against the duty assessed by it upon a succession any duty charged on the same succession by the other sovereign party to the agreement. In bringing about reciprocity of this nature Ontario was a pioneer and leader among the provinces. As early as 1905 the succession duty legislation of Ontario provided that reciprocal arrangements might be entered into and, if deemed necessary, subsequently revoked by orders-in-council. The other provinces in due course adopted similar legislation. The first order-in-council issued by Ontario under the act of 1905 was one dated 12th

[10]In the words of the resolution, this succession duty was to be "applicable to all real estate within the Province, irrespective of the domicile of the deceased, and to all personal estate wherever situate of a deceased domiciled within the Province." Sixth Annual Report of the Manitoba Tax Commission (for 1925), p. 29.

[11]See p. 113.

[12]Budget speech of the Minister of Finance for British Columbia (Hon. J. D. MacLean), 1st February 1927. p. 55.

January 1906 which authorized the deduction from succession duties levied in Ontario of any duplicate duties payable in Great Britain. This order-in-council appears to have been made not as part of a formal agreement with Great Britain but in return for a concession extended to the province ten years previously. During the years 1896 to 1898 Great Britain had extended to most of the Canadian provinces the benefit of section 20 of the Finance Act of 1894 whereby, in respect of any property subject to both the Imperial estate duty and a provincial succession duty, the duty payable in the province was made deductible from the duty payable in Great Britain.[13] Following Ontario's lead, all the remaining provinces promulgated orders-in-council granting corresponding relief for duties enacted in Great Britain.

Following the issue of the order-in-council in favour of Great Britain, Ontario made orders-in-council authorizing on a reciprocal basis deduction from the Ontario duty of duty already paid in the following provinces: Nova Scotia and New Brunswick (1907), British Columbia and Saskatchewan (1908), and Manitoba (1909). The requirement of reciprocity was, however, expunged from the law by an amendment of 1910, and the executive has ever since then had power, similar to that possessed by the executive in Great Britain, to extend concessions of this type to such

[13]Section 20 of the *Finance Act, 1894*, reads as follows:

"20. (1) Where the Commissioners are satisfied, that in a British possession to which this section applies, duty is payable by reason of a death in respect of any property situate in such possession and passing on such death, they shall allow a sum equal to the amount of that duty to be deducted from the Estate Duty payable in respect of that property on the same death.

"(2) Nothing in this Act shall be held to create a charge for Estate Duty on any property situate in a British possession, while so situate, or to authorise the Commissioners to take any proceedings in a British possession for the recovery of any Estate Duty.

"(3) Her Majesty the Queen may, by Order in Council, apply this section to any British possession, where her Majesty is satisfied that, by the law of such possession, either no duty is leviable in respect of property situate in the United Kingdom when passing on death, or that the law of such possession as respects any duty so leviable is to the like effect as the foregoing provisions of this section.

"(4) Her Majesty in Council may revoke any such Order, where it appears that the law of the British possession has been so altered that it would not authorise the making of an Order under this section."

Orders-in-council were made under this section in favour of the Canadian provinces as follows: In 1896, Ontario, Manitoba, and British Columbia; in 1897, Quebec and New Brunswick; in 1898, Nova Scotia. Soward and Willan, *The Taxation of Capital*, London, 1919, p. 159, note.

jurisdictions and on such terms as it saw fit, even without reciprocity. Concessions were extended accordingly to Prince Edward Island (in 1912), Quebec (1918), and Alberta (1919). A slight change, operative 13th June 1925, having been made in the concessionary legislation, the provincial succession duty authorities, without the formality of a rescinding order-in-council, judged fit to disregard the concessions previously granted with regard to all the provinces, excepting Nova Scotia, British Columbia, and Alberta, from and after that date, inasmuch as only those three provinces had effected concessions in favour of Ontario (British Columbia had done so by order-in-council in 1908; in Nova Scotia the crediting of foreign duty had been since 1900 automatic; Alberta had not pretended to tax outside property).

Whereas the concessions just discussed took the form of a crediting of duty on the part of Ontario, in 1928 a second type of concession was introduced in the form of an immunity from duty on the part of Ontario; intangible personalty in Ontario belonging to a domiciled decedent of a reciprocating jurisdiction was exempted from succession duty in Ontario, provided that that jurisdiction imposed no tax on the intangibles of Ontario domiciled decedents. Recripocal agreements to this effect were entered into with Prince Edward Island and New Brunswick in 1930 and 1934 respectively.[14]

By 1934, therefore, Ontario, while retaining reciprocal crediting concessions with British Columbia, Nova Scotia, and Alberta (which had begun to tax outside personalty in 1929, but with which Ontario had continued its agreement), had added reciprocal agreements on the immunity basis with Prince Edward Island and New Brunswick. British Columbia and Alberta had exchanged crediting concessions since 1930; and both these provinces did the same with New Brunswick in 1935. The provinces of Manitoba, Saskatchewan and Quebec had never entered into reciprocal succession duty arrangements with any province. The continuing lack of reciprocity between Ontario and Quebec is

[14]For a very helpful account of the arrangements, reciprocal and otherwise, between Ontario and the other provinces of the Dominion with respect to succession duty, I am much indebted to Mr. J. D. O'Brien, K.C., Senior Solicitor of the Succession Duty Branch of the Province of Ontario.

particularly regrettable, for these two provinces contain a considerable percentage of the population and wealth of the Dominion, and in one or the other of these two provinces the principal transfer office (usually, but not necessarily, the head office) of the leading industrial and financial enterprises of the country, and therefore the probable taxable situs of their shares, is to be found.[15] Unsuccessful attempts were made in 1925 and in 1931 to arrive at an arrangement; it has been supposed that the second attempt fell through on account of failure to reach a common definition of intangible personalty.

Beyond the position attained in 1935, the process of narrowing by reciprocal agreements the field for duplication in Canadian death taxes has not proceeded. Far worse, practically the whole of the ground gained during a period of nearly thirty years by means of concessions and agreements was subsequently abruptly retraced. On 19th May 1937 Alberta cancelled its agreements with Ontario, British Columbia, and New Brunswick, and also abolished the credit for death taxes paid in Great Britain. Two weeks later Ontario in retaliation broke off its concession to Alberta, and at the same time by a so-called "mutual understanding" rescinded its concessions and immunities affecting British Columbia, Nova Scotia, and New Brunswick, though leaving in force the order-in-council permitting the allowances for death duties paid in Great Britain.[16] British Columbia, like Ontario, did away with the concession to Alberta.[17] There remains, therefore, only the reciprocal agreement between British Columbia and New Brunswick, out of all those once operative among Canadian provinces for preventing duplication of death tax levies.[18] Reciprocal agreements of this nature may contribute to fiscal equity, but they involve for both parties some loss of revenue. In terminating the

[15]But, *cf.*

[16]A reciprocal arrangement instituted by Ontario in May 1934 with the colony of Trinidad and Tobago also remains in force.

[17]A reciprocal arrangement instituted by British Columbia in July 1936 with the colony of British Guiana also remains in force.

[18]One more form of concession may be alluded to. Between 1909 and 1934 it was legally provided in Ontario that death duty paid elsewhere, if not credited against Ontario duty, might be deducted from the dutiable value of the property itself, on the same basis as debts. In Manitoba and British Columbia also, at one time, similar legal provisions existed. In the 1934 re-enactment, however, this deduction disappeared from the Ontario law.

agreements into which they had entered with other provinces and states, Alberta and Ontario evidently attached little weight to non-revenue considerations.

The tale of retrogression in connection with reciprocal death tax agreements is unfortunately not yet fully told. In the course of 1928 and 1929 Ontario concluded agreements for reciprocal death tax exemptions with twenty-six American states, the District of Columbia, and the Territory of Hawaii. But in 1934 the province abrogated every one of these agreements, an action motivated in all probability, like the corresponding step taken by the province three years later in respect of its inter-provincial pacts, mainly, if not solely, by revenue considerations. The writer has it on high authority that the province found an added inducement to jettison its numerous agreements with the states of the American Republic in the series of Supreme Court decisions culminating in the judgment in the case of *First National Bank of Boston* v. *Maine* [284 U.S. 312 (1932)] which precluded any state from levying an inheritance tax on intangible personalty locally situate but belonging to the estate of a non-resident decedent. If it were assumed that the position would remain unchanged if the decedent died domiciled outside the United States, rather than in another state of the Union, the outside jurisdiction, say Ontario for illustration, would no longer need reciprocal agreements with the several states to safeguard the estates of Ontario decedents against the double taxation of assets consisting of intangible personalty located in the United States. In that event, Ontario, by repealing the agreements, would be left free to tax locally situate intangible personalty forming part of the estate of a person dying domiciled in one of the states, while in the reverse situation no tax would be levied by the American state government. In other words, granting the assumption that, by the decision in the case of *First National Bank of Boston* v. *Maine*, the American states were in all instances precluded from taxing intangible personalty except on the basis of domicile, the tax exemption in favour of the estates of Ontario decedents which Ontario formerly attained by means of reciprocal agreements with the individual states, that province now obtains without such agreement. But while the Supreme Court of the United States has not definitely passed upon the question of whether the principle underlying the

decision in *First National Bank of Boston* v. *Maine* could be extended to the taxation by a state of intangibles belonging to the estate of a decedent whose domicile was without the United States, it would seem, at least inferentially, from the judgment of the Supreme Court in *Burnet* v. *Brooks* (1933)—a case in which the federal government was held to have power to tax the locally situate securities of a non-resident alien—that the court considered the restrictions of its decision in *First National Bank of Boston* v. *Maine* to apply only to the relations between the several states of the Union.[19] The question has, however, come before the higher courts of one of the states. In a case brought before the Supreme Court of the State of Washington in 1936, that court (reversing the decision of the lower court) did indeed hold that the locally situate intangible property comprised in the assets of a decedent domiciled outside of the United States was subject to the death tax levied by the state. Recent instances have come to the writer's attention where the State of Washington did in fact levy a death tax on the locally situate intangibles of an Ontario domiciled

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[19]In *Burnett v. Brooks*, 288 U.S. 378 (1933), the Supreme Court held that the principle that one state of the Union may not tax securities kept in the state owned by a resident of another state is a limitation due to the relations of the states to each other in the American consitutional system and had no application to the power of the federal government to tax the property of a non-resident alien.

". . . . If there is no constitutional barrier preventing the federal government from exercising its sovereignty in the taxation of intangibles physically within the United States owned by a subject of a foreign country, it would seem that there should not be any constitutional barrier preventing a state in its sovereignty from similarly taxing intangibles having a situs within its country owned by a citizen of a foreign country. . . . Of course the state statute must, by its terms, affirmatively show an intention to tax." R. G. Kidder, "State Inheritance Taxation and Taxability of Trusts" (1934).

For an extremely helpful letter, discussing the question of the applicability of the principle established in *First National Bank of Boston* v. *Maine* to a case where a state and a foreign jurisdiction, and not two states, are involved, I am much indebted to Francis Colt de Wolf, Esq., of the Treaty Division, State Department, Washington, D.C. This sub-note and the main note which it amplifies are based upon the information so kindly furnished in this letter.

While, in the absence of a treaty or reciprocal convention providing to the contrary, the federal government of the United States may levy an estate duty on property belonging to non-residents, the rate of such duty is based only on the value of the assets situated within the United States. By contrast, the Canadian provinces levy succession duty, to the extent to which they are entitled to do so in respect of outside property, at a rate based on the value of the decedent's whole estate.

decedent. But whether, since the decision in *First National Bank of Boston* v. *Maine*, other states have levied death taxes in like circumstances the writer cannot say.

The attempts made to cope with the problem of double death duties along two lines have now been reviewed, and the outcome noted. The endeavours made to promote uniform legislation came to nothing. More was accomplished by means of reciprocal agreements, but the progress made was extremely limited, while the instability of these agreements was, by the unilateral action of the Alberta and Ontario governments, startlingly demonstrated. To provide against inequitable duplication in provincial succession duties, there exists at present neither uniformity in legislation nor reciprocity in tax allowances. It remains to be seen whether the decisions of the courts have yielded any more tangible and permanent results.

**Double Death Taxes and Court Decisions**

When called upon to determine whether or not a provincial succession duty was within the province and to that extent valid or not, the Privy Council has consistently differentiated between a tax levied on the property of the decedent and one imposed on the transmission of the property to a beneficiary. The *Woodruff* case of 1908, it will be recalled, established that when the subject matter of the tax is property a province may not levy succession duty on personal property situated elsewhere. The right of a province to tax not the extra-provincial personal property of a resident decedent as such, but the transmission of that property to a resident beneficiary was in 1914 successfully challenged when, in the case of *Cotton* v. *The King*,[20] the Privy Council declared *ultra vires* the Succession Duties Act of Quebec, which then provided solely for a tax on the transmission of a resident decedent's property. The decision rested, however, on the circumstance that the statute was not drawn in terms sufficiently wide to empower the province to levy the tax under consideration, as the statute purported to tax only the transmission of property actually situate in Quebec.[21]

The province accordingly broadened the scope of its succession duty so as to apply to the transmission within the

[20] (1914) A.C. 176.

[21] The tax was, moreover, held indirect in form, and on this ground, too, declared *ultra vires*.

province of the outside personal property of a resident beneficiary.[22] The statute so amended came before the Privy Council in 1922 in the *Sharples* case [23] and was held good to cover a tax imposed by the province on the transmission to a resident beneficiary of shares in various companies, whose head offices were outside Quebec, forming part of the estate of a resident decedent. But in delivering judgment, Lord Phillimore, after referring to the provisions of the statute, declared that the condition that a transmission be within the province "can, in their Lordships' opinion, only be satisfied if the person to whom the property is transmitted is, as the universal legatee in this case was, either domiciled or ordinarily resident within the Province."

What this dictum implied to be law was, in the *Kerr* case (1933),[24] expressly made so. This case, like the *Sharples* case, concerned the right of a province (Alberta, as it happened) to impose a succession duty in respect of the outside personal property of a domiciled decedent passing to a resident beneficiary. But, whereas in the *Sharples* case the tax imposed by Quebec was on the transmission of property, the subject matter of the tax levied under the Alberta Act was in the *Kerr* case held by the Judicial Committee to be not, as the Province contended, the transmission, but the property itself. In other words, the Alberta tax was of the kind which it had been decided as far back as 1908—in the *Woodruff* case—no province had the power to levy. Their Lordships did not content themselves with distinguishing the Alberta tax as a levy on property, but proceeded to define the conditions under which a province could validly claim succession duty in respect of personal property outside its borders.

> In their Lordships' opinion, the principle to be derived from the decisions of this Board is that the Province, on the death of a person domiciled within the Province, is not entitled to impose taxation in respect of personal property locally situate outside the Province, but that it is entitled to impose taxation on persons domiciled or resident within the Province in respect of the transmission to them under the Provincial law of personal property locally situate outside the Province.[25]

[22] Beyond this, the act was revised so as to make the taxation direct, while a tax on property within the province was added to the tax on the transmission of property.

[23] *Allwyn-Sharples* v. *Barthe* (1922) 1 A.C. 215.

[24] *Provincial Treasurer of Alberta* v. *Kerr* (1933), A.C. 710.

[25] *Provincial Treasurer of Alberta* v. *Kerr* (1933), A.C. 718.

Much confusion and uncertainty as to the limits of provincial powers in regard to death taxes had in the past arisen out of the varying interpretations placed by provincial authorities and Canadian courts on the old *mobilia* rule. In a notable passage the judgment in the *Kerr* case clarified the matter as follows:

> The Province next contended that, although locally situate outside the Province, the personal property of a person, who dies domiciled within the Province, is to be treated as "within the Province" for the purposes of section 92 of the British North America Act, by reason of the application of the rule embodied in the maxim *mobilia sequuntur personam*. This argument appears to proceed on a misunderstanding of the meaning and effect of that rule. If A dies domiciled in the United States of America, leaving movable property locally situate in England, the latter country has complete jurisdiction over the property, but the law of England, in order to decide on whom the property devolves on the death of A, will not apply the English law of succession, but will ascertain and apply the American law. In other words, it is the law of England—not the law of America—that applies the principle of *mobilia sequuntur personam* in exercising its jurisdiction over the movable property in England, the locus of the latter remaining unchanged; in no sense could the property be described as "within America." [26]

The *mobilia* rule, then, cannot be applied, as it was long thought by many it could, so as to attach to personal property actually situate outside a province a constructive situs within it. But by the courtesy of the law of the jurisdiction in which the property has its situs, the transmission of the property is governed by the law of the province in which the decedent died domiciled. This transmission the province of domicile may tax, though only when the transmission is wholly within the province, that is to say, when the beneficiary is, as the decedent was, domiciled there. The *Kerr* case revealed that the succession duty acts of most of the provinces were in their existing form in fact unconstitutional, for while, as they were phrased, the subject matter of the duty was property, they purported, nevertheless, to tax the outside personal property of a domiciled decedent. Amendments to cure this defect were, however, readily effected.[27] The amended acts are similar in scope to the

[26] *Provincial Treasurer of Alberta* v. *Kerr* (1933) A.C. 721.

[27] In the *Kerr* case the Privy Council found that the form of the existing Alberta statute (the Succession Duty Act of 1922) was also such as to make the duties imposed under it indirect. This defect the province easily remedied by the enactment, in 1934, of a revised statute. It became apparent from the Kerr decision that the succession duty statutes of a number of other provinces, which were similar

revised statute enacted in Quebec in 1922, following the *Sharples* case. With the possible exception of Prince Edward Island and Nova Scotia, every province now taxes at death property within the province and the transmission within the province of outside personalty.

While Quebec in 1922 put its Succession Duties Act into constitutional form, it resorted, in the same year, to an ingenious device to do what the dictum of Lord Phillimore in the *Sharples* case had implied a province might not do, namely, to levy a death tax on the succession by a non-resident to outside personalty comprised in the estate of a deceased resident. A new act was passed, entitled the Beneficiaries' Seizin Act, which provided in substance that in the case of such a succession the non-resident could not obtain complete title to the property without an order from the Quebec court, to obtain which he was required to pay, according to the degree of his relationship to the decedent, a court fee of 3%, 9%, or 15% of the value of the property.[28] The so-called court fee was, however, obviously a succession duty, and in 1938, when for the first time its imposition was challenged in the courts, the Quebec court of first instance declared it invalid.[29] Thereupon, without appealing to the higher courts, the province promptly repealed the Act.

The question as to how far the difficulties of double taxation in connection with death duties have been met by court decisions may now be answered. The practical effect of the relevant judgments has been to narrow the scope for double taxation to the case where the person dying domiciled in province A leaves to a beneficiary resident in that province personalty situated in province B.[30] Double taxation may arise under these circumstances because it is

in form to the Alberta act of 1922, were also of very dubious constitutionality. These statutes were accordingly patched, after the Alberta pattern, so as to leave no further basis for judicial invalidation on the ground of indirectness of the levies.

28 Cf. footnote 3.

29 *Gary* v. *The King*, 76 Quebec Superior Court Reports, 66 (1938).

30 But a province could probably validly impose a succession duty on the beneficiary in respect of his inheritance, as distinct from a tax on the property in the estate or on the transmission of the property. No province has yet attempted to levy a succession duty specifically on the beneficiary. In so far as it might validly do so it would not be necessary to the validity of the tax that both the testator and the beneficiary should be domiciled in the province. It would be sufficient if the beneficiary were domiciled there.

possible under the *British North America Act* by appropriate wording of the provincial statutes—and as a result of the Judicial Committee's decisions in the *Kerr* case and in the previous cases cited nearly all provincial succession duty statutes are now suitably drafted—for a succession duty to be validly levied by province A upon the transmission of the property, and by province B upon the property itself.

The fact that Canadian death duties could assume this duality in form was, in the case of *The King* v. *Cotton* when it came before the Supreme Court of Canada,[31] deprecated by Mr. Justice Anglin. He argued that the substantial result of the tax, and not the mere form of the taxing act, should be considered. If each province could select its own basis of taxation, one choosing transmission and constructive situs according to the *mobilia* maxim, and the other property and actual situs, the outcome would necessarily be double taxation with its attendant uncertainty and confusion. It was, he believed, in effect, the property which was affected by the tax. Consequently, he concluded (and he was dealing, be it remembered, with a Quebec statute purporting to tax on the basis of transmission): "that the property so to be affected should itself be within the province at the time when the taxation attaches in respect of it seems to me to be *prima facie* the restriction which the Imperial Parliament intended to impose upon the provincial power of taxation in respect of property. . . . In fact movables actually situate outside the borders of the province are as far beyond the 'direct power' of the Quebec Legislature as immovables similarly situate." [32]

### Judicial Remedy in United States

Mr. Justice Anglin's view that succession duties could validly be levied upon one basis only—the basis in his judgment being the situs of the property—has unfortunately not influenced either the law or the practice of death taxation in Canada. By contrast, in the United States, the Supreme Court has shown marked hostility to double taxation in death taxes and has looked to the substantial result of state inheritance tax acts and not merely to their form.

[31] 45 S.C.R. 469.

[32] See Kennedy and Wells, "The Law of the Taxing Power in Canada," University of Toronto Studies in Law, 1931, p. 112.

In the series of notable death tax cases culminating in *First National Bank of Boston* v. *Maine*, the Supreme Court concluded that with respect to tangible personal property only the state of situs could levy an inheritance tax, while in the case of intangibles the tax could be levied only by the state in which the owner died domiciled.[33] It is true that double taxation may still arise where questions of business situs are involved [34] and where two or more states claim to be the domicile of a decedent,[35] but with these exceptions the decisions of the Supreme Court have virtually cured a condition of double, or, indeed, multiple, death taxation, which was at one time far more serious and far more chaotic than Canada has ever known. But under the refinements of Canadian constitutional law, where a succession duty may be, at one and the same time, a tax on property levied on the basis of situs and a tax on a transmission levied on the basis of a decedent's domicile, a logical and practical solution of the problem of double duties by judicial decision, comparable to that arrived at (with the exceptions noted) in the United States, would seem to be unattainable. The limits of reform by court decisions within the framework of the *British North America Act* have probably already been reached.

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[33] These cases were as follows:

Relating to tangible personalty:

*Frick* v. *Pennsylvania* [268 U.S. 473 (1925)].

Relating to intangibles:

*Farmers' Loan and Trust Company* v. *Minnesota* [280 U.S. 204 (1930)] (as to state and municipal bonds and certificates of indebtedness).

*Baldwin* v. *Missouri* [281 U.S. 586 (1930)] (as to bank deposits, promissory notes, and bonds of the United States).

*Beidler* v. *South Carolina Tax Commission* [282 U.S. 1 (1930)] (as to an unsecured debt upon the books of a corporation).

*First National Bank of Boston* v. *Maine* [284 U.S. 312 (1932)] (as to shares).

[34] It appears that borrowed funds constituting part of the assets used in a business may still have a *business situs* in the state where the business is carried on and be subjected to an inheritance tax there, even though the owner of the business was a resident of another jurisdiction. See R. C. Brown, "Multiple Taxation by the States—What is Left of It," 48 *Harvard Law Review* 420 (1935).

[35] See e.g. First, Second, Third, and Fourth Reports of the Committee of the National Tax Association on Double Domicile in Inheritance Taxation, Proceedings of the N.T.A. for 1935 to 1938 (inclusive).

## Avoiding Double Taxation

Even in the absence of a uniform succession duty act or of inter-provincial agreements, it is possible for an individual by legitimate means to safeguard his estate against taxation of the same intangibles by more than one province. An investor may establish in P, the province of his domicile, a personal holding company; turn over to it all his investments; and then draw his income from this company. He would then be the owner merely of shares in the company; the situs of these shares would be P; and, upon the owner's death domiciled in P, P alone would have power to tax either the property or its transmission to a resident beneficiary. But unless an estate is of a goodly size, say over $100,000, this device is unlikely to be of any advantage, for the cost of setting up a holding company may exceed the possible saving to the estate from the avoidance of double death tax levies.

Short of establishing a holding company, an investor, by securing and acting upon expert legal and investment advice, may reduce double taxation upon his estate to a minimum. But here again is a resource not easily commanded, except by the comparatively well-to-do.

A special device, which since 1931 has enabled investors of non-Canadian domicile to make investments in Canada without fear of having them subjected to death duties on the basis of situs, may be appropriately mentioned here, for this device, though availed of, there is reason to believe, chiefly by British and American investors, is also a means by which Canadian investors may seek to avoid double death taxes. This device became available in 1931, it is understood, as a consequence of the ingenuity of a number of Montreal lawyers and the willingness of the government of Prince Edward Island to adopt their proposals. In that year the province enacted a special Companies' Tax Act applicable to companies domiciled within the meaning of the Act. A company, wherever and however incorporated and constituted, may become so domiciled by meeting the following requirements: It must establish its head office in Prince Edward Island, or at least keep a transfer register there. The head office need, though, only be nominally in the province, for it may be located, as may the transfer register, merely in the office of any trust company within the province. The company may not hold property in

Prince Edward Island, may not offer securities for sale in the province, or otherwise compete with companies actually operating in the Island, and it must show that 95% of its issued securities are held by non-residents. Such companies are required to pay annually to the province a tax amounting to $50 where the capital is $100,000 or less, rising to $200 where the capital is $500,000 but less than $1 million, and advancing by increments of $100 for each additional $1 million of paid-up capital to a maximum of $1,500. Apart from this tax, no succession duty or other tax may be levied by the province in respect of any of the assets of the company or any of its issued securities. By 1936, 361 holding companies, the majority of them probably originating in Great Britain or the United States, had become "domiciled" in Prince Edward Island.[36]

A wealthy Canadian domiciled in one of the mainland Canadian provinces can, as already explained, avoid taxation at death of his security investments by another province than that of his domicile by incorporating a personal holding company in his own province, so that he may have no need to take advantage of the Prince Edward Island act. But, it would appear, where a Canadian investment trust issuing shares to the public establishes its domicile in Charlottetown, an Ontario investor, for example, will have the comfort of knowing that, at his death, the succession to his shares will be taxed by Ontario only, and not by, say, Quebec too, as might be the case if the investment trust had its head office in Montreal.[37]

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[36] The number of companies domiciled in Prince Edward Island within the meaning of the Special Companies' Tax Act rose from 38 in 1931 to 321 in 1936, and declined to 227 in 1939. The special tax levied on these companies produced in the three given years 16, 70 and 61 thousand dollars, respectively. (Public Accounts of Prince Edward Island).

[37] The following extract, from a circular issued to its shareholders on 19th May 1937 by the Commonwealth International Corporation Limited of Montreal, illustrates the above point:

"*By-Law No. XIV.* The reason for the proposed change of the Head Office from Montreal to Charlottetown, P.E.I., is for the purpose of avoiding double succession duties in that no succession duties are levied in Prince Edward Island. This is a great advantage to the large number of shareholders resident outside of the Province of Quebec, who, as owners of Commonwealth Stock, now have their estates liable to succession duties not only in their own province or state but in the Province of Quebec as well. To those shareholders resident in Quebec, it will of course make no difference as they are liable to Quebec succession duties in any case."

### A General Remedy Still Necessary

The several devices noted above provide no substitute for a solution of the problem of double death duties. They deal with only a small part of the problem; they are availed of, it may reasonably be assumed, chiefly by the wealthy; and they add, consequently, to the inequity of the situation by leaving these double taxes to impinge chiefly on moderate-sized and comparatively small estates. In all probability, comparatively few of the estates probated in Canada which contain some investment securities entirely escape double taxation.[38] The solution which is still most frequently proposed is *via* reciprocal agreements. But that the problem will be solved by such means seems at present less likely than it ever was. Even if new agreements could be negotiated, the fact that they might at any time be discarded at the will of a provincial executive and practically without warning—as evidenced by the action taken recently in Alberta and Ontario—constitutes an inherent weakness. From the point of view of the executors of the estate, it may be added, reciprocal agreements, so far as they have been operated in Canada, have worked none too smoothly. Not infrequently the task of obtaining the necessary waivers of tax from a given province proved a highly troublesome one, for it was by no means rare for difficulties to be raised

[38] In Australasia, it may be of interest to note, there is practically no problem of discriminatory double taxation in connection with death duties. The Australasian legislation respecting the taxation of outside personalty is indicated below:

The estate-duty acts of the Dominion of New Zealand and of the Commonwealth of Australia provide that in respect of outside personalty any foreign duty paid elsewhere is to be credited against the Dominion or Commonwealth duty, in all cases without question of reciprocity. The states of New South Wales and Tasmania provide similarly for the unreserved crediting of foreign duty against their own, but only in respect of personalty elsewhere in the Empire. Victoria and Western Australia do not pretend to tax personalty outside their borders. Thus the two central governments and four states bar double taxation of outside personalty, and without reciprocity.

South Australia allows the crediting against its own duty of duty paid in respect of outside personalty to a reciprocating state, that is, a state which either does not tax personalty situate in South Australia or which credits South Australian duty against its own in respect of such personalty. South Australia recognizes as reciprocating states the United Kingdom and New Zealand, and also every state in the Australian Commonwealth, except Queensland. Queensland taxes outside personalty of domiciliaries, but allows no rebates.

Generally speaking, then, free deduction is the rule in Australasia; one state only requires reciprocity, and one state allows no deduction.

which could be overcome only after much correspondence and sometimes protracted negotiations. It may be asked, is the problem of double death taxes really of much significance? The answer must be yes, for not only is a principle involved—that of the inequity of discriminatory double taxation—but, as mentioned above, it is very likely that the great majority of estates which contain shares are subjected in some degree to duplicatory death taxes.

### Ultimate Solution of Problem

The failure of the provinces to make any lasting progress towards the elimination of double death taxes makes it doubtful whether this fiscal inequity can ever be permanently overcome so long as the provinces continue to levy these taxes. The Dominion could validly enter the succession duty field as the government of the United States has done, but such action could not of itself suffice to do away with the injustice. To remove double taxation it would be necessary for the provinces to withdraw entirely from the field, so permitting the Dominion to become the sole tax-levying authority.

Such indeed was the conclusion reached by the Royal Commission on Dominion-Provincial Relations.[39] But that the transfer of succession duties from the provinces to the exclusive jurisdiction of the Dominion would put an end to double taxation was not the only reason for which the Commission recommended the transfer. Many other supporting considerations were advanced by the Commission; these may be summarized as follows: "Every large estate in recent times has been at least in part accumulated out of profits from nation-wide enterprises," so that the provinces have no moral right to the exclusive enjoyment of succession duties. The great variability of the duties makes them unsuitable for provincial use. The Dominion would be able to use death taxes as an instrument of social policy more effectively than can the separate provinces. With the Dominion as the sole tax-levying authority death taxes would be uniform throughout the country, thereby precluding the use of competitively low rates as a magnet to attract capital and wealthy residents from one province to another. At present succession duties in Canada are far from onerous

[39] Report of the Commission, Book 2, Chap. 111(3). King's Printer, Ottawa, 1940.

and they yield per capita much less than do death taxes in Australia or New Zealand.[40] If it should be desired to exploit this source of revenue more fully, "the most economical method of doing so, and the method least harmful to the national economy, is by the Dominion alone." Through its administration of the income tax and the gift tax the Dominion would be better able than any province to check the returns made for death tax purposes, and tax evasion would be correspondingly more difficult. "The Dominion is probably in a better position than any single province to deter citizens of Canada from establishing domiciles outside Canada for the purpose of escaping from liability for Canadian inheritance taxes." Dominion administration would also reduce the cost of tax compliance, since returns would have to be made to one authority only, instead of to several authorities, as is now frequently the case, while the elimination of all dispute as to whether given intangibles in an estate are liable to taxation by more than one province would save executors much troublesome correspondence and, not infrequently, spare them vexatious litigation. In short, "the Dominion would be a more efficient tax-gatherer than nine provincial jurisdictions in that it could collect the most revenue at any given rate with least injury to the taxpayer and least harm to the national income." The Commission pointed out, however, that if its recommendation as to the transfer of succession duties from the provinces to the Dominion were implemented, it would be particularly important . . . . to provide for decentralized collection and to give local collectors adequate authority to clear estates promptly. Nothing, the Commission added, "could be more indefensible and irritating than prolonged negotiations, at a time of emotional strain and probable financial demands, with a distant authority over details which could be settled immediately by a man on the spot." [41]

The Commission's proposals as to succession duties, it must be borne in mind, constitute only part of a comprehensive plan for fiscal and financial readjustment in Canada, formulated by the Commission in a notable and extensive

[40] "For the ten-year period 1926-35, the yield of inheritance taxes per capita was annually from 1.8 to 3.8 times as large in Australia as in Canada and from 2.1 to 5.2 times as large in New Zealand as in Canada." *Ibid.*, Book 2, p. 120.

[41] Report of the Commission, Book 2, p. 120.

report. This plan involves the complete withdrawal of the provinces not only from the succession duty field but also from the fields of income taxes and corporation taxes, and the transfer of these tax sources to the Dominion for its own use. The Plan calls upon the provinces to give up also their existing Dominion subsidies. As a *quid pro quo* to the provinces for the surrender of these revenues the Plan requires that the Dominion assume all provincial debts — carrying, however, only their deadweight burden,[42] free the provinces of all responsibility for the relief of unemployed employables, and give the financially weaker provinces National Adjustment Grants—reappraisable every five years —sufficient to enable them to maintain an average Canadian standard of governmental services with no more than average Canadian taxation. In so far as succession duties are concerned, the Commission urged that if its recommendations were not adopted and the provinces elected to retain the duties, "every effort should be made to work out a common inheritance tax program for all provinces, and to entrust collection to the Dominion which would redistribute on an agreed basis." [43] This at least, the Commission declared, would minimize double taxation.

The Commission's recommendations were based on a study of conditions prior to the outbreak of the present war. But a delay in the publication of the report until May 1940 gave the Commission an opportunity to review its recommendations in the light of the changed situation. The result was a declaration of belief by the Commission that its basic recommendations were "appropriate to meet the new strains and emergencies of war conditions." [44] For some months there seemed little prospect that any attempt would be made to implement the report. Eventually, however, a Dominion-Provincial conference for the discussion of the Commission's proposals was arranged. The conference met in Ottawa on 14th January of this year, only to be abruptly terminated the next day by the refusal of the premiers of Ontario, Alberta, and British Columbia to proceed further

[42] The Plan provides that the Dominion should assume all provincial debts, whether deadweight or revenue-producing, but that the provinces should pay to the Dominion a fixed annual sum equal to the interest received on their investments in the most recent appropriate fiscal year.

[43] Report of the Commission, Book 2, p. 120.

[44] *Ibid.*, Book 1, introductory letter submitting the report.

with the discussion of the report, to which they declared themselves opposed in principle. One possible consequence of the debacle may be that the need for war revenue may sooner or later force the Dominion to enter the succession duty field, but, as already noted, so long as the provinces continue to occupy the field also, such a step, whatever its advantages, would not eliminate double death taxation.[45] Whether ways and means will yet be found of winning the united support of the provinces for the Commission's recommendations, thereby making it possible, in addition to other fiscal reforms, to do away in Canada with the particular fiscal evil—double death taxes—with which this article has been concerned, time alone will reveal.

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## OIL ROYALTIES AND THE ACCOUNTANT

**By A. Patrick Bowsher, Calgary, Alberta**

DURING the past few years the steadily increasing popularity of oil royalties as an investment medium and as a means of financing the development of oil lands has resulted in great changes in methods of financing and in the corporate structure of operating oil companies and has, as a consequence, thrust upon the accountant many new problems, both in his connection with financial houses and with operating oil companies. Some of these problems will be discussed in a general way in this article.

Webster defines a royalty as "a share in the profit or profits paid to the owner by one who develops or uses the property, as to an author on sales of his book, or to an owner of a patent for articles manufactured or sold, etc." Based on this definition, a royalty in an oil well would be described as that share of production, derived from an oil well, paid to a landowner or to the vendor of a lease in consideration for the use or assignment of the lease. It is stated by some that this is the only true royalty so far as the oil industry is concerned. However, certain "working interests" in the production of oil wells or lands have through general usage become known as royalties, and these interests, together with the so-called "true royalty," will be referred to as "royalties" in this article.

[45] This (see footnote 2a) has now happened.

In order that the reader may refresh his memory on the subject of royalties, it is suggested that he read the informative article by W. F. Reid, C.A., published in the July 1938 issue of THE CANADIAN CHARTERED ACCOUNTANT in which the various types of royalties are described in some detail.

The oil royalty, at least in its present form, is essentially a child of the depression although it was not until 1937 that it began to come into its own in the financial structure of the Canadian oil industry.

During the years from 1929 to 1937 oil development in the Turner Valley field was carried on under great handicaps. No money was available from the public for development purposes and any development which was carried on was financed out of revenue from producing properties or through private contributions. Up till 1936 Turner Valley had been considered a naptha or gas field and production consisted of large quantities of natural gasoline. Declining pressure and production resulted in smaller returns to the investor and his lack of interest in further development.

The pioneer crude oil well in Turner Valley was financed partly by private means and partly by the sale of royalty interests. The successful completion of this discovery well as a crude oil producer in June 1936 started the royalty on its meteoric rise to fame.

**Some Royalty Returns in Alberta**

A one per cent gross royalty in this discovery well has returned to the original purchaser in the period from June 1936 to January 1941 the astounding sum of $8,858.29 on an original investment of less than $2,000.00, and it is currently returning monthly approximately $40.00.

Other royalties on some of the older wells in Turner Valley have returned their original cost twice and even three times over. Some of these, with dates of first payments and returns to date, are set out hereunder:—

| *Well* | *Class of royalty* | *First payment* | | *Paid to date* |
|---|---|---|---|---|
| Commoil #1 ... | Gross | October | 1937 | $7,304.70 |
| Pacific #1 ..... | Gross | April | 1938 | 4,310.76 |
| Vulcan-Brown .. | Gross | June | 1938 | 6,259.50 |
| Coronation #1 . | Gross | December | 1937 | 3,863.28 |
| Davies #1 ..... | Gross | March | 1938 | 2,966.40 |

| | | | | |
|---|---|---|---|---|
| Davies #2 ..... | Gross | September | 1937 | 6,916.45 |
| Pacific #3 ..... | Gross | November | 1938 | 2,420.99 |
| Prairie #1 ..... | Gross | October | 1937 | 6,166.53 |

When it is realized that the rates of return set out above have been the rule rather than the exception, it is easily understood why the oil royalty has achieved such popularity. Many former stock brokerage firms and bond houses have opened royalty departments and many firms have been incorporated to deal exclusively in royalties. Royalty dealer associations have been set up to work in close co-operation with the various governmental security departments. There is strict supervision both by government departments and dealer associations over new issues and methods of distribution, with the result that when a royalty is offered to the public it is morally certain that the well in question has been financed to completion and will be completed. For these reasons, and by its own satisfactory performance, the royalty has earned for itself the approval of even that wary individual, the banker, and, like the radio, "it seems it's here to stay."

### Accounting for Royalties

The accountant in his connection with developing and operating companies is confronted with some problems in the treatment and recording of royalties. Two classes of companies have taken advantage of the royalty market as a means of financing development. These two classes are (a) those companies that have been operating for some time and that may have a certain amount of revenue, which however may not be sufficient to finance development, and that sell royalty interests to assist in the financing of a proposed well; and (b) those companies that finance their complete development programme through the sale of royalties.

In the case of the company selling royalties for the financing of a portion only of the drilling costs of a well, the accountant's first and main problem has to do with the manner in which the proceeds of the sale of the royalties shall be recorded. At this point it may be advisable to consider the bookkeeping entries. The receipt of funds from the sale of royalties may be recorded as follows:

| | | | |
|---|---|---|---|
| Dr. | Cash .................... | $45,000 | |
| Cr. | Proceeds from sale of royalties ................ | | $45,000 |
| | Recording sale of 15 per cent royalty (Well No. —) at $3,000 per 1 per cent | | |

### Royalties in the Balance Sheet

Some accountants subscribe to the belief that "Proceeds from the Sale of Royalties" should be set out on the liability side of the balance sheet in the same manner as debentures or share capital, while others agree that the item should be deducted from Leases and Development account. It is suggested that the latter treatment is to be preferred for the following reasons:

(a) As the company in question is one financed by the issue of shares, the balance sheet of such a company is intended to inform the shareholders of the state of their company's affairs and, in the case of an oil company, to inform them so far as it is possible as to what has taken place. In order to set before the shareholders a statement which will show them a history of the activities of the company, it certainly must be necessary to show how much they as shareholders have contributed to the cost of development. The development account on the balance sheet, therefore, should include that proportion paid for by company funds and this can be shown only by deducting from that account the amount contributed by royalty holders.

(b) The sale of a royalty is an alienation of the "right to receive" a certain proportion of the production which may be derived from a certain well or lease. In the hands of the vendor company the proceeds from the sale of royalties on its property is nothing more or less than a realization of the selling price of a proportion of its assets, and as such should be deducted from the account in which such asset was recorded.

(c) A royalty is not refundable, that is, there is no liability on the part of the company to refund to the royalty holders any portion of the moneys contributed by them or to account to them for the manner in which such funds are expended. There is, of course, a liability on the company to drill the well on which it has sold royalties and to pay or cause to be paid to the royalty holders a proportion of

the proceeds of production from such well. These liabilities, being unknown quantities, cannot readily be set forth in a balance sheet.

As it appears reasonable and logical to consider the sale of royalties as a sale of a proportion of the company's assets or as a reduction of the cost of the remaining assets, it is suggested that the company's Leasehold and Development account should be set forth in the balance sheet as follows:—

*Assets*

| | | | |
|---|---|---|---|
| Leasehold and Development Account | | | |
| Leasehold property (mineral rights) ................ | $..... | | |
| Development account ........ | ..... | | |
| | ..... | | |
| *Less* Proceeds from sale of royalties .............. | ..... | $..... | |

The case of the company financed entirely by the sale of royalties requires somewhat different treatment. The only assets of this company are those purchased out of funds contributed by the royalty holders and they probably consist of a lease or leases and little else beyond an unexpended cash balance which will be used to pay for drilling costs. In an operation of this nature the company, usually a private company with only a nominal share capital, acts merely as a trustee or disbursing agent for the royalty holders. The royalty holders have no interest in the assets acquired by the company; their only claim is on income which may be produced. In the event of the well ceasing to produce, the royalty holders, having received their agreed proportion of production, would have no claim on any salvage which may be recovered from the well unless specifically provided for. The accounts of such a company do not present any great difficulties; its balance sheet is a simple matter and is prepared only to meet statutory requirements.

Such a company, acting as a trustee for royalty holders, may set up its accounts so as to show as a liability to royalty holders an amount equal to the unexpended cash balance from time to time. The following journal entries set out the procedure to be followed in this case:

| | | | |
|---|---|---|---|
| Dr. | Cash ................. | $180,000 | |
| Cr. | Royalty holders ...... | | $180,000 |
| | Recording sale of 60 royalty units at $3,000 | | |

The following entry records expenditure by the company of $100,000 on development:

| | | | |
|---|---|---|---|
| Dr. | Royalty holders ...... | $100,000 | |
| Cr. | Cash ................. | | $100,000 |

The company at this stage has cash on hand amounting to $80,000 and shows a liability to or for the account of royalty holders of the same amount.

In the event that the well costs more to complete than was provided by the sale of royalties—and this is quite often the case—such excess must be recovered out of the proceeds of production otherwise available for distribution to royalty holders. Assuming the expenditure of a further $100,000 on development, the company's position might be set out as follows:

| *Assets* | | *Liabilities* | |
|---|---|---|---|
| Cash ............. | nil | Accounts payable .. | $20,000 |
| Royalty holders ... | $20,000 | | |

**Production and Royalty Holders**

First receipts from production would be credited to royalty holders and used to discharge liabilities, after which the proceeds of production, less necessary deductions, would be available for distribution among royalty holders.

Assuming net proceeds of production for the first month to be $25,000 after deduction of gross royalties and operating expenses, the following entries would record the application of the funds received:

| | | | |
|---|---|---|---|
| Dr. | Cash ................... | $25,000 | |
| Cr. | Royalty holders ......... | | $25,000 |
| | Recording the receipt of net proceeds of production | | |
| Dr. | Accounts payable ........ | 20,000 | |
| Cr. | Cash .................... | | 20,000 |
| | Recording payment of liabilities out of cash | | |
| Dr. | Royalty holders ......... | 5,000 | |
| Cr. | Cash .................... | | 5,000 |
| | Recording distribution of cash balance to royalty holders | | |

While the foregoing entries may not be acceptable from the point of view of strict corporate accounting, they are intended to show the methods by which the position of the company, as regards its relationship to royalty holders, may be determined.

The price at which royalties are issued for the financing of development is approximately the proportion of the cost of the well applicable to such royalty. For instance, assuming the lease to be developed is subject to a gross royalty of 20%, the remaining 80%, subject to deduction of operating expenses, may be sold to provide funds for development. The cost of drilling the well and providing production equipment is estimated at $210,000 which sets the price to be obtained for each of the 80 units of royalty at $2,625, to which must be added selling expenses, dealer profits, etc. when arriving at the cost to the purchaser.

The net preferred royalty came into being as a means of returning to the royalty holder the amount of his contribution, before any payments are made to promoters or other holders of net deferred royalties. Instead of the foregoing simple set-up, the promoters would probably follow the plan described below:

The cost of drilling would be estimated at $190,000 and the cost of production equipment at $20,000. Royalty trusts would be set up covering 60 net preferred royalties and 20 net deferred royalties. The preferred royalties would be sold to provide funds to cover the cost of drilling and the deferred royalties would be held by promoters or issued as a bonus for the sale of preferred royalties. The preferred royalties would be entitled to the full production from the well, less cost of production equipment, any deficiency in drilling funds and operating costs until the sum of, say $3,750, has been paid in respect of each such royalty unit. As the preferred royalties will be sold to provide the sum of $190,000, the price of these units is set at $3,166 net to the company.

The value of a producing royalty is governed entirely by the amount it earns and by the physical qualities of the well and efficiency of its operation. A rule-of-thumb method which may be used to value such a royalty is that it should return from 2 to 3 per cent of its cost per month. This return should not be considered entirely as income

as it includes a proportionate amount of returned capital. The proportionate amounts of income and return of capital are as yet unknown although several estimates have been made. The allowance made by some income tax departments in this regard will be discussed below.

Various estimates have been made as to the productive life of Turner Valley. It is fairly well accepted that the field may average a production of approximately 20,000 barrels per acre of drainage. A well draining a 40 acre lease, therefore, may be expected to produce 800,000 barrels of oil with an approximate value of $1,000,000. Operating costs including installation of production equipment will probably amount to 20 cents per barrel, or a total of $160,000 for the life of the well. The amount available for net royalties during the productive life of the well will amount to $640,000 as set out hereunder:—

| | | |
|---|---|---|
| Gross production ......... | | $1,000,000 |
| *Deduct:* | | |
| Gross royalties 20% .... | $200,000 | |
| Operating costs ........ | 160,000 | 360,000 |
| Net production ........... | | $ 640,000 |

Of this amount, $536,250 would be paid to the holders of the 60 net preferred royalties and $103,750 to the holders of the 20 net deferred royalties. In other words an investor in a net preferred royalty costing $3,750 may expect to receive the sum of $8,937.50 if he holds the royalty for the productive life of the well.

## Taxation and Royalty Interests

Conflicting rulings in connection with the taxation of returns from royalty interests are at present the great deterrent to a more widespread acceptance of the oil royalty as an investment medium. The Dominion income tax department allows a deduction for depletion of 25% of the amount received as do some of the Provincial tax departments. The Province of British Columbia, however, makes no such allowance and demands tax on the full amount returned. The holder of a net preferred royalty would pay a Dominion income tax on the following income, based on the foregoing estimates of returns received by him:

| | |
|---|---|
| Gross income from royalty .......... | $8,937.50 |
| *Less* Allowance for depletion 25% ..... | 2,234.37 |
| | $6,703.13 |

In this case, it is plainly seen that the allowance for depletion is wholly inadequate, the situation in British Columbia in this regard being such that no consideration is given to the wasting nature of the investment. Until the various income tax departments recognize the nature of such investments and make a fair and reasonable allowance therefor, the royalty holder will be the object of discrimination in the matter of income taxation, and the oil industry will to that extent be restricted in its development. It is the inalienable right of the taxpayer so to arrange his affairs that a minimum of income tax will be payable on the returns therefrom and it is to be expected that the royalty holder, when he realizes his position, will be receptive to reorganization plans which will lighten his tax burden or, at least, render more reasonable the basis of taxation.

As corporate financing by the sale of royalties is just one step in the evolution of oil company financing methods, it may be expected that when the royalty market reaches the point of saturation the next step will be taken. What this step will be is not difficult to imagine; already several companies have sold debenture issues for financing purposes. These issues have been well received by the public and it is to be expected that other companies will follow the example of the pioneers in this development. Granted a successful venture, the investor obviates the danger of being required to pay tax on the return of his capital and appears to have every chance of receiving a reasonable return on his investment, plus a certain amount of security which was not his while he held only royalties.

It is to be hoped that these few remarks will throw some light on the subject of oil royalties which, like some other branches of accounting, has been clothed in mystery which on closer examination is wholly undeserved. The royalty is really a simple fellow who unwittingly has proved to be the saviour and guardian angel of the Alberta oil industry. If the reader concludes that the oil royalty is now somewhat less of a mystery, the writer will feel well paid.

# FORMS IN MODERN BUSINESS

By R. A. Hicks, Chartered Accountant, Toronto

BUSINESS forms are often described as "tools of management," but it is only within the past few years that their true importance has been fully recognized.

It is not difficult to visualize the small manufacturer of many years ago. We find a one-man organization, a few workers, limited sales, no office, no clerks, no clerical tools. Manufacturing is largely piece-work by hand, with orders being solicited in person by the proprietor. In many cases he and perhaps one assistant not only sell but actually manufacture the product. Delivery is made in person and payment received on the spot in specie or produce. As a result early business required few, if any, forms. Orders from out of town were transmitted on letterheads or blank correspondence stationery. Instructions for manufacture were given verbally or jotted down on a scrap of paper, and delivery was effected by messenger or in care of the stage driver. Billheads were drawn up by hand on blank paper and a little later credit was extended and transactions were entered in a notebook with a column for marking in "paid" when the buyer called with the money. Banks were little known and little used, with most businesses operating on a "cash and carry" basis.

With the development of transportation and widened markets, small businesses expanded with the growth of population and it became increasingly difficult for the manufacturer to operate verbally or from memory. Billheads were designed and printed, ornate letterheads were laid out and stocked and, little by little, more and more forms were required to transmit instructions or information, or to serve as records. We now consider these early forms very naïve and perhaps a little amusing.

In contrast with these simple beginnings, we find the large and small corporations of today, manufacturers, retailers and wholesalers using multiple copy forms, scientifically designed for use in any typewriter, business machines, or for hand writing in order to reduce to a minimum transcription and duplication of work. The use of modern continuous forms daily releases workers for more productive efforts. Production line methods that formerly applied

mainly to production and manufacturing are now being applied to office routines in which a properly designed and constructed form plays a very important part.

Business methods have been revolutionized in the last decade, and manufacturing processes have been and will continue to be more efficient. In some trades one worker performs the operations that formerly required five workmen through the use of automatic machines. Scientific management has for many years concentrated its efforts on reducing factory costs, speeding up the manufacture of a product and the marketing thereof.

Selling has shared in the effort of business to discard non-essentials, to obtain lower costs and to give greater value for the dollar. Salesmen are becoming experts in their particular field, and buyers and purchasing agents also are becoming practical, impersonal, and analytical.

Despite nation-wide concentration on increasing the efficiency of the major operations in business, the forms that make possible the conduct of business have received relatively little attention. Business has been revolutionized, but the tools that transmit instructions and record information have too often been the same old tools. Office management today, however, is beginning to utilize automatic machines and automatic efforts to speed up its work. Calculating machines have replaced clerks mentally adding up columns of figures and machines now save a vast amount of pen work. The routine non-productive efforts involved in preparing to type multiple forms is being eliminated, and the forms themselves, single or multiple, are being made more efficient by a careful study of their layout.

It is important to think of such a form as a tool, to design it as a tool, and to use it as a tool. A poorly designed tool, made of the wrong material, handled in the wrong way, would not last any time even in old-fashioned factories. The single purpose of a hammer for instance is to strike a blow. How much more important are these forms when one considers that business is conducted on them and that raw materials are ordered, manufactured, shipped, invoiced and paid for through their use. Many "hammers" are put to work with the manufacture of locomotives received on single purchase order forms. Yet a design of a hammer is probably more carefully considered by its manufacturer than the design of a form by its user.

Form inefficiencies are chargeable to the use of unnecessary forms, uncombined forms, or poorly designed forms on the wrong paper. So much emphasis has of late years been put on increased factory efficiency and lower factory costs, that form losses have not been noticed or stopped. For instance, conditions that once required certain forms are often removed, but the forms are continued and it has been found that many of them now in use are unnecessary and that their continued use requires in the aggregate a large amount of unproductive time, energy and wasted money. Again, many present-day forms could be economically combined with others to eliminate unproductive work. Further, many necessary forms are too large, too small, or perhaps printed on too good or too poor a paper. They may be difficult to fill out or interpret, and typographical layout may be poor with no standardization in the style of type or the colours of papers used. Also, for example, too many envelopes are addressed when window envelopes will serve the purpose equally well.

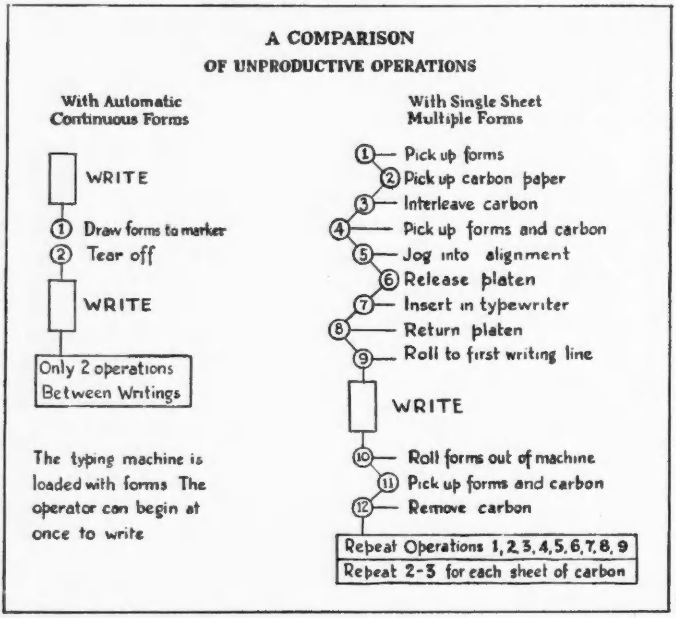
Following the development of forms generally, the invention of carbon paper was the first labour-saving improvement in form handling and record making. Carbon paper made possible multiple copy forms thus eliminating many repetitive writings. As a further stage in this evolution was the invention of continuous multiple forms and typing machines or registers, which would handle these operations automatically.

Multiple forms are ordinarily supplied in single sheets, generally padded on one side in convenient quantities. Before they can be typed, sheets of carbon paper must be interleaved between the parts of the multiple form set. Then the prepared set must be loaded into the typing machine if the form is to be typed. This preparatory work is the unproductive time-consuming operation which continuous forms eliminate and thus increase clerical efficiency.

Literally billions of continuous multiple forms are used annually. This enormous consumption would not be possible unless an important principle was involved, the same principle which has made this continent the world leader in manufacturing. It is the principle of automatic feed resulting in the continuous flow of work, and this principle is just as inherent in roll paper used in making forms as it

is inherent in a roll of wire used in making nails. Cut the paper or wire in a single piece and its inherent principle is permanently lost. Unproductive work for the typist adds materially to the labour of the paper maker and the printer.

Automatic feed is brought to multiple copy forms by printing them in continuous strips, one after the other, with the various copies and parts collated together in the proper order. The necessary sheets of carbon paper are retained in the typing machine, or one-time carbon is collated between all copies of the continuous set by the manufacturer, so that they reach the user ready for immediate use. This elimination of individual sheet and carbon handling results in considerable saving of time when taken in the aggregate. The following chart will serve to illustrate this.




Forms make clerical work easier, and provide the basis of executive action and the formation of policies. Most forms, after they have transmitted instructions, become records. Some are designed as records, while others ac-

cumulate information from which records are made. Most multiple forms serve both purposes, part or parts, transmitting instructions and part, or parts, becoming records. As an example of this, let us look at the typical multiple copy form system combining invoice, order form, and express forms.

Part 1—Invoice—transmits the charge and then becomes the customer's record and justification of payment.

Part 2—Duplicate invoice—informs customer's purchasing department that the order has been billed. This copy is often attached to and filed with their copy of the purchase order.

Part 3—Charge slip—a record of charge becomes the basis of reports.

Part 4—Stock record copy—serves as instructions to stores for specific shipment and as authority for a record of a disbursement.

Part 5—Original express receipt—instructs the express company to transport package with charge prepaid or collect.

Part 6—Duplicate express receipt—a record of shipment; a receipt from the express company, and a proof of shipment when sent to customer with invoice.

Part 7—Packing slip and label—the packing slip informs the receiver of the contents of the package and serves as customer's receiving clerk's check; the label instructs the carrier to transmit the package to a particular customer at a certain address in one city.

Part 8—Shipping room copy—instructs the shipping department to be on the lookout for certain items in stores. Instructs them where, how and when to ship. This form then becomes a record.

Part 9—Salesman's file copy—transmits information to salesman that order has been received and acted upon; becomes a part of his record of sale to his customers.

Part 10—Salesman's copy—serves as an extra record for the salesman's personal use.

Another example of how extra typings and writings can be eliminated through combining related copies is the invoice-ledger system. A six-part form may include the following copies:—

Part 1—Customer's copy—sent to customer.

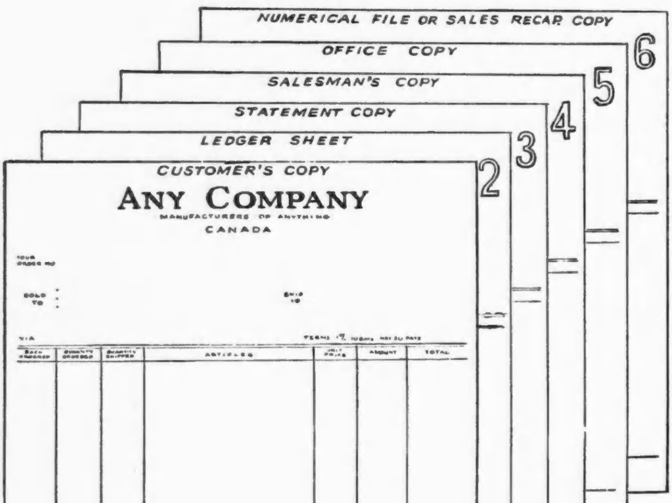
Part 2—Ledger sheet—filed alphabetically—no transcription necessary.

Part 3—Statement copy—sent to customer 30 days after date of invoice provided the account has not been paid.

Part 4—Salesman's copy—sent to salesman as evidence that order was shipped.

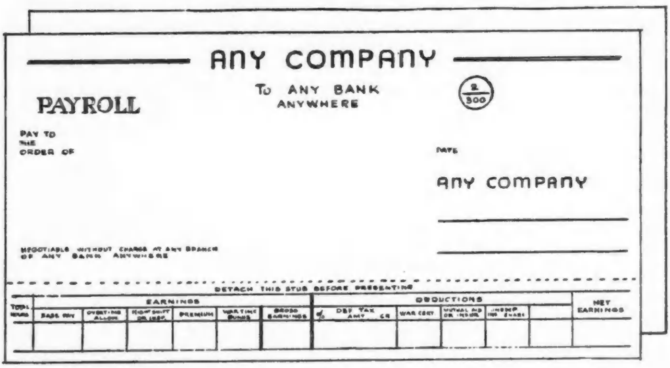
Part 5—Office copy—used for commission calculations.

Part 6—Numerical file or sales recap, copy—total for shipments for the month—product distribution, sales tax calculations, etc.



It will be noted that with one typing, six related records are completed and individual postings to an accounts receivable ledger are eliminated.

Regardless of the type or size of the corporation, a payroll must be prepared and cheques issued. A record must also be maintained for income tax reports, workmen's compensation reports, and a summary of wages paid for employer information. The payroll method described below may be used over any typewriter. The first copy—the cheque—goes to the employee and the second copy is filed by employee name or number in a permanent file. The cheque the employee receives is $4\frac{1}{4}$ inches deep. Before presenting it to the bank he detaches the 1 inch stub and this is kept for his own information as a record of his earnings and deductions for the pay period.




The employer's copy is filed by name or number. At the end of the year, fifty-two have accumulated for each employee, provided payments are made weekly, behind each employee's name or number. For income tax, workmen's compensation purposes, etc., all that it is necessary to do is to add the gross amounts appearing on the copies and transfer the total to the master sheet. The old method was to transcribe the information from the payroll with the chances of error being fifty-two times the number of employees.

The autographic register should also prove of interest to professional accountants and auditors and to others con-

cerned with inventory and cash control. With an autographic register it is possible to supply the auditor with a definite, unbroken sequence of numbered records. This is made possible through the use of a locked compartment. The form, or forms, that are required to be kept under lock and key are automatically refolded in this locked compartment when the form is written, with the key available only to the supervisor. With this method of control a positive check can be made on all numbers, with no possibility of erasures or changes being made on the file copies. This system would be invaluable for a stockkeeper in a manufacturing concern, for cash sale receipts, receiving records, etc.

Another interesting application of continuous forms is the purchase order. The usual purchase order consists of four parts—

Part 1—Vendor's copy—sent to supplier.

Part 2—Requisitioner's copy—as information to the person requesting the purchase of certain goods that the actual purchase order has been issued.

Part 3—Purchasing department copy—filed as a follow-up to make sure that shipment is made on time, and as a check on the incoming invoice and receiving record.

Part 4—Receiving room copy—by use of an uncarbonized strip between the third and fourth parts, the receiving department is required to make an actual count on all items received, and mark this quantity on their copy and send it in to the Purchasing Department along with the receiving record. In this way, a definite tie-up is made between the original purchase order, the actual quantities received, and the vendor's invoice.

It will be noted that with continuous forms it is unnecessary to handle manually carbon sheets. With carbon interleaved forms the carbon is all ready in place between the copies and all sets are ready for immediate use. With continuous forms the employer is getting the maximum output from his clerks. Formerly, if it was necessary to type a seven-part form, the operator had to handle and bring together seven opaque sheets and six carbon sheets. With

continuous forms, these sheets are all in order and ready for typing.

Some forms are not economically convertible to continuous style. The systems analyst representing the larger continuous forms manufacturers is best equipped to inform the interested company as to the adaptability of his forms to a continuous system. Many initial installations are made up of a simple two or three-part multiple form probably being supplied in padded style. No attempt has been made to build a comprehensive system by consolidating the form with other related copies. When this is done, other forms, both single and multiple, in themselves not always adaptable to continuous style, become so. For example, labels, packing slips, delivery receipts and shipping orders.

The four or five related copies are combined and the savings represented by the elimination of extra writings will justify the installation of a continuous form billing machine or typewriter, even though only 10M or 15M such multiple forms are used each year, not to mention the added convenience, speed and other features they always make possible. In short, there are many factors to be considered on each installation. It is the duty of the system analyst to study these factors. His extended experience, doing such work for hundreds of companies, enables him to bring a fresh, trained point of view to each contemplated installation.

## ECONOMIC NOTES

### War and the Sirois Commission Report

*Editor's Note:* This is another in a series of notes on economic subjects by Lawrence B. Jack, M.A., Montreal.

WHEN the Dominion-Provincial Conference on the Sirois Commission Report became wrecked on the rock of petty politics, one of the most disheartening collateral developments was the attitude of the many people who felt that indefinite postponement of reform would be advisable, and even necessary, for the duration of the war.

It was to be expected that narrow sectional interests and those who by nature fear change would oppose the Commission's suggestions in greater or less degree. What could hardly have been foreseen, however, was the too common feeling that to implement the Report would rock the boat disastrously; that to follow an intelligent guide out of financial chaos would in some inscrutable way mutilate the country's war effort. Some of those who took this attitude were either indifferent or lukewarm toward the Commission's proposals; some decried further centralization of governmental authority and others were helplessly resigned to its coming, but only in the indefinite future. All, however, apparently failed to see that in the economic sphere this war is pushing centralization on all fronts far more rapidly than would ever have been possible in peace-time. The obvious lesson should then be that the country failing to get into this current of events will be hopelessly handicapped. The corollary to the lesson is that action should be taken immediately along the lines proposed.

Even the Nazis have grasped the principle that centralization of administration (plus, of course, diversification of resources) is a prime source of power and a requisite of efficiency in the modern world. German ambitions for continental and even world domination are not wholly motivated by Hitler's megalomania: there is a small basis of economic good sense underlying their aggressions. After making all due allowance for their general habit of trying to dignify and exalt emotional urges into philosophical or scientific systems, German studies in the field of "geopolitics" show the small basis of rationality underlying their ambitions. Arguing from the example of the United States, which is fortunate enough to be able to apply modern productive techniques to a continental economy, the Nazis

believe that they can achieve a dominant position by applying their techniques on a (hitherto undefined) continental scale. That they propose to do this on an impossible and indefensible basis of inequality, Germans being "the master race" and the rest being serfs, does not in any way invalidate the proposition that in centralization of administration and diversity of resources lies economic strength. They are fully aware that, given any particular area, its atomization will be a source of weakness, whereas its unity and *uniformity* will enable its administrators to develop it to best advantage.

Obviously Canadians can derive no lessons in technique from this latest German attempt, on a tremendous and impossibly disruptive scale, to transform Europe's economic chaos into their own insane variant of the ideal of order, stability and abundance. On the other hand there is a great deal to learn from the precedent set by the series of experiments at the other end of the scale initiated in Great Britain since the outbreak of war in the field of local government. Operating within a field of familiar reference and without harming other nations or classes, the British have made tremendous strides in organizing these most essential and stubbornly democratic units of government in a manner very close in spirit to that permeating the Sirois Commission Report. Moreover, the fact that war emergencies dictated these reforms in no way reduces the value of the lesson they contain.

Problems of civil defence, especially since the "blitzkrieg" got under way, have shown that pre-war municipal divisions were hopelessly inefficient to cope with difficulties of war magnitude. At the same time it was evident that excessive centralization would throttle local initiative and the democratic spirit, besides swamping the central government in administrative detail. As a result, it has been necessary to set up twelve regional administrative areas, and this organization has proven so efficient that all government departments (except the Ministries of Trade, Education and Agriculture) operate through them. Thus, it has been finally realized under duress that only relatively large local units can give adequate service; otherwise the central government must take over full powers under some subsidy scheme. This, in effect, is only one step removed from a peace-time reorganization which will so widen local taxa-

tion areas that a depression in one part can normally be balanced by prosperity in another part of the same area.

This new development envisages governmental authority stratified in three levels, as in the case of a federal government—but, it is hoped, without its concomitant disabilities. At the top would be the central planning authority, in the middle the regional administrations, and at the bottom what are cautiously described as "the smallest efficient planning units." The result would be that regionalism will then provide a field of operation where central standards of efficiency can meet local habits of democracy, to their mutual advantage.

Nothing as pat and neat, of course, can be devised for Canada. Geography, language and the accidents of history have imposed provincial limits where regional divisions would probably be vastly more efficient. But within the confines of federalism and provincialism some solution, at least as adequate as the British, must be found in order to streamline Canada's finances and economy into an efficient competing unit in a world that will be far harder to survive in than at any time in our past. The Sirois Commission Report gave one answer to the problem. The burden lies upon those who opposed it, or who thought its adoption in war-time would unduly rock the boat, to propose suitable alternatives. Without waiting for the compulsion of physical aggression, Canadians surely should be able to progress by agreement at least as far as the British in untangling existing financial and administrative snarls.

Montreal, L. B. JACK

16th August 1941.

## GLIMPSES OF CURRENT ACCOUNTING LITERATURE

### Bulletins

ONE of the significant donations which the United States has contributed in the field of current accounting literature has been made by the Committee on Accounting Procedure of The American Institute of Accountants, 13 East 41st Street, New York City, in the Accounting Research Bulletins which have been published from time to time.

Bulletin No. 1—General introduction and rules formerly adopted, September 1939

Bulletin No. 2—Unamortized discount and redemption premium on bonds refunded, September 1939

Bulletin No. 3—Quasi-reorganization or corporate readjustment—Amplification of Institute Rule No. 2 of 1934, September 1939

Bulletin No. 4—Foreign operations and foreign exchange, December 1939

Bulletin No. 5—Depreciation on appreciation, April 1940 (see pages 8-18, volume 37, *The Canadian Chartered Accountant*)

Bulletin No. 6—Comparative statements, April 1940 (see pages 19-21, volume 37, *The Canadian Chartered Accountant*)

Bulletin No. 7—Reports of Committee on Terminology, November 1940.

Bulletin No. 8 on the "Combined statement of income and earned surplus," issued in February 1941, is reproduced in the July 1941 issue of the *Journal of Accountancy*. This bulletin is concerned primarily with form rather than accounting principles and deals with the advantages and disadvantages and limitations of the combined statement. The Committee sets out specifically in the bulletin the necessity for distinguishing between charges against income and charges against earned surplus. "To summarize the combined income and earned surplus statement serves the purpose of showing in one statement both earnings applicable to the period proper and also modifications of earned surplus on a long-run basis."

Bulletin No. 9 on "Terminology" issued by the Commit-

tee on Accounting Procedure of the American Institute of Accountants in May 1941 serves to summarize the work of the Committee on Terminology of the Institute to date. The bulletin sets forth the specialized senses in which certain accounting terms are used. It indicates that the proper interpretation of accounting terms may be made only when a clear understanding prevails as to the rules or principles of accounting connected with the term defined. Much of the confusion arising from the apparent historical record as the basis for accounting would be removed by a clear understanding of the accounting concepts underlying the terms used.

Bulletin No. 10 on "Real and Personal Property Taxes" issued in June 1941, is reproduced in the July 1941 issue of the *Journal of Accountancy.* Although the bulletin does not make any positive recommendations it does urge the *early* accrual of tax liabilities and the separate disclosure of tax expenses on the income statement. "Taxes themselves, especially federal taxes, have lagged behind governmental expenditures. As a result, it may be said that business enterprises are subject to a large but indeterminate future liability which has not been reflected in their accounting statements." The appendix to the bulletin tabulates the current practice of accounting for taxes followed by 500 corporations on their 1938 and 1939 published statements. One item of particular interest in the tabulation is the extent to which taxes are disclosed as separate items in the financial statements. Another item of interest is that out of 51 reports examined showing special adjustment for taxes (in most cases applicable to prior years) 47 made such adjustments through the surplus account.

**Monographs**

The American Accounting Association, 6525 Sheridan Road, Chicago, Illinois, has also made a significant contribution to current accounting literature in the monographs which it has published on the basis of research which has been carried on by certain of its members in the accounting field. Three of these have been published.

Monograph No. 1.—"Principles of public-utility depreciation," by Perry Mason

Monograph No. 2—"Financial statements," by M. B. Daniels.

Monograph No. 3—"An Introduction to Corporate Accounting Standards," by W. A. Paton and A. C. Littleton.

Monograph No. 3, "An introduction to corporate accounting standards," has been mentioned as one of the really significant contributions to recent accounting literature.

### Current Articles—Inventories

A. C. Littleton in a paper "Inventory Variations" delivered before the St. Louis Chapter of the Missouri Society of Certified Public Accountants on 10th April 1941, which was reproduced in the July 1941 issue of the *Journal of Accountancy* advocates the acceptance of accounting standards with stated variations in place of the application of the present rigid accounting principles and rules which are in use.

In compliance with the nature of the business enterprise and the related purpose of accounting, he indicates the necessity for providing a utilitarian concept which is flexible enough to be applied to the individual case without destroying any of the significant aspects of a situation in its application. The matter of flexibility is stressed. "Both 'principle' and 'rule' fail to imply that graded alternatives exist; they both seem to suggest that they rest on some middle ground, some compromise between better and worse."

In referring to the item of inventories, he stresses that different interpretations placed on the item of inventories require the application of different standards of valuation and that a single rule such as "the lower of cost or market" may not be applied intelligently as a general rule, but merely to the situation to which it applies. It would not be applicable where the inventory is considered a factor in the calculation of net profit, where the inventory account is considered as "unamortized outlay costs." The answer is to use an accounting standard in the sense of a preferred treatment with a point of departure so designed as to cover the situation existing.

As a practical application of his suggestions, an inventory standard is set up and the possible variations outlined are broken down into necessary variations, acceptable variations, questionable variations, and rejected variations.

In an interesting article in the June 1941 issue of the

*Journal of Accountancy*, Edward A. Krache attempts to present a reconciliation between the "cost or market" and the "costs and costs only" theories of inventory valuation. The basis of the reconciliation is constructed on the premise that the basic difference between "sales aptitudes" (degree to which selling prices reflect increased costs) would seem to be the answer to whether market did or did not need to be taken into consideration in valuing inventories for the income account.

A further interesting suggestion is made in the article setting out that the basis of valuation used for inventories should be primarily determined by the use for which the statement to which it applies is prepared. The basis of valuation of the inventory for income statement purposes may on this basis vary with that utilized for balance sheet purposes. In the case of such a variance a separate basis of valuation should be used for each, the reconciliation would be supplied by an "expansion point" represented by a reserve account set up by an adjustment of surplus. In this way, where the question of providing a purely balance sheet reserve for inventories arises (a proper presentation of the current position in the balance sheet), it is met without permitting such a provision to confuse the stated results of regular operations.

# THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

## OFFICERS AND COUNCIL

*Executive Committee 1941-42*

| | |
|---|---|
| President | Malcolm C. McCannel, C.A., Edmonton, Alberta |
| Vice-Presidents | Kris A. Mapp, F.C.A., Toronto, Ontario<br>H. L. McMackin, C.A., Saint John, N.B. |
| Immediate Past President | W. G. Rowe, C.A., Vancouver, B.C. |
| Chairman, Finance Committee | Fred C. Hurst, F.C.A., Toronto, Ontario |
| Chairman, Legislation Committee | Clayton F. Elderkin, C.A., Montreal, Quebec |
| Additional Member Executive Committee | Frederick Johnson, C.A., Winnipeg, Manitoba |
| Secretary-Treasurer | Austin H. Carr, M.A., C.A., 10 Adelaide St. East, Toronto |

*Council 1941-42*

| *Representatives* | *Elected by* |
|---|---|
| H. A. Black, C.A., Edmonton<br>M. G. Graves, C.A., Calgary<br>M. C. McCannel, C.A., Edmonton | The Institute of Chartered Accountants of Alberta |
| K. D. Creer, C.A., Vancouver<br>Wm. Macintosh, C.A., Vancouver<br>J. Haydn Young, C.A., Vancouver | The Institute of Chartered Accountants of British Columbia |
| R. T. Cunningham, C.A., Winnipeg<br>William Gray, C.A., Winnipeg<br>Frederick Johnson, C.A., Winnipeg | The Institute of Chartered Accountants of Manitoba |
| H. G. Norman, C.A., Montreal<br>Arthur E. Cox, F.C.A., Saint John | The New Brunswick Institute of Chartered Accountants |
| T. H. Johnson, C.A., Halifax<br>G. E. Martin, C.A., Halifax | The Institute of Chartered Accountants of Nova Scotia |
| J. F. Gibson, F.C.A., Toronto<br>R. R. Grant, F.C.A., Toronto<br>F. C. Hurst, F.C.A., Toronto | The Institute of Chartered Accountants of Ontario |
| T. H. Johnson, C.A., Halifax | The Institute of Chartered Accountants of Prince Edward Island |
| Wm. H. Campbell, C.A., Montreal<br>C. F. Elderkin, C.A., Montreal<br>Alfred Smibert, C.A., Montreal | The Society of Chartered Acccountants of the Province of Quebec |
| C. P. DeRoche, C.A., Saskatoon<br>M. Hesford, F.C.A., Swift Current<br>G. G. Patrick, C.A., Saskatoon | The Institute of Chartered Accountants of Saskatchewan |

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Chairman of War Purposes Committee—Kris A. Mapp, F.C.A.
Chairman, Magazine Committee—Harold P. Herington, F.C.A.
Chairman, Committee on Education and Examinations—Gerald Jephcott, F.C.A.
Chairman, Committee on Accounting Research—D. McK. McClelland, F.C.A.
Chairman, Committee on Accounting Terminology—John Parton, F.C.A.

## GENERAL NOTES

### Our Contributors This Month

A. PATRICK BOWSHER who writes on oil royalties this month was born in Ayama, British Columbia. He was for ten years on the staff of Helliwell, Maclachlan & Co., chartered accountants, Vancouver, passed his Intermediate examination, but through ill health was unable to complete his course of studies. For the past three years Mr. Bowsher has been secretary of Pacific Petroleums, Limited, an oil-producing company in the Turner Valley field, and is now in the Calgary offices of the company.

RUSSELL ARTHUR HICKS whose article "Forms in Modern Business" appears this month entered the firm of Edwards, Morgan & Co., chartered accountants, on 1st October 1935. In December of the same year he won the gold medal for highest standing in business investigations and he was admitted a member of the Ontario Institute in February 1936. Mr. Hicks is now comptroller of Burt Business Forms Limited.

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### Annual Meeting of Association

The thirty-ninth annual meeting of The Dominion Association of Chartered Accountants, which was held in the Hotel Vancouver and was a successful one, had just drawn to a close when this month's issue went to press. A report of the proceedings will be published in next month's issue. The officers, members of council and chairmen of the various committees of the Association for 1941-42 are published on page 197 of this month's issue.

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### Secretary Manitoba Institute Passes

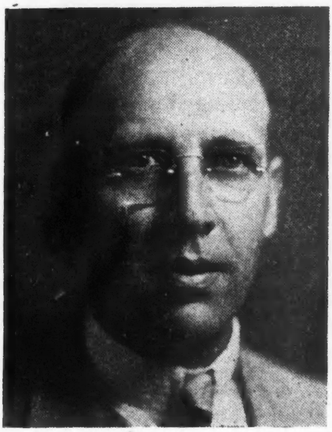
The news of the sudden death from a heart attack of Fred C. Gilbert, the popular and efficient Secretary of The Institute of Chartered Accountants of Manitoba, has come as a shock to all who had the privilege of knowing him. A reference to the work of Mr. Gilbert will be made in our October issue.

## Dominion Prize Winners in the June 1941 Final Examination of the Provincial Institutes of Chartered Accountants

J. R. Hardie

JOHN ROBERT HARDIE, Calgary, a candidate of The Institute of Chartered Accountants of Alberta, was awarded the Gold Medal and cash prize of $50 of The Dominion Association of Chartered Accountants for the candidate winning first place in Canada in the Final examination conducted in June 1941 throughout the Dominion by the Provincial Institutes of Chartered Accountants. Mr. Hardie was born 5th May 1919 and was President last year of the Calgary Chartered Accountant Students' Association.

JOHN WILLIAMSON NICOL, a candidate of the Society of Chartered Accountants of the Province of Quebec, obtained the second highest standing in the Dominion in the Final examination and was awarded the Silver Medal and prize of $25 of The Dominion Association of Chartered Accountants.



J. W. Nicol

## Annual Meeting of American Institute

The fifty-fourth annual meeting of the American Institute of Accountants will be held in Detroit, Michigan, 15th to 18th September 1941. The Institute has sent a kind invitation to members of the Dominion Association to be present.

The council of our Association has appointed as its official representatives at this meeting the President of the Dominion Association, Malcolm C. McCannel, C.A., Edmonton, and the Secretary-Treasurer, Austin H. Carr, C.A., Toronto.

## The Blonde Case

A decision of the Ontario Court of Appeal in *re Blonde et al.* concerning the situs of shares for succession duty purposes has created considerable interest in legal and accounting circles. A brief reference to the case may be found in the column of legal decisions published this month.

## The Gold Standard

*The Gold Standard* is the title of an essay of ninety-four pages prepared by W. Redelmeier and published by The MacLean Publishing Company, Toronto. C. M. Short, Economist of The Canadian Bank of Commerce, in his introduction to the book, commends the work to everyone interested in the sound economic reconstruction which all democratic people hope will follow the present devastating war in Europe. Mr. Redelmeier, who now lives in Canada and is engaged in industry here, was a well-known European banker and during the past thirty years became familiar with banking and currency problems in three of the most important European centres—London, Antwerp and Amsterdam. The book may be obtained at $1 from the publishers, and the proceeds of the sale are being turned over to the Toronto War Hospitals Committee for Canadian war hospitals.

## Past Record of Germany

*Black Record—Germans Past and Present* is the full text of Sir Robert Vansittart's broadcasts on the German people,

delivered in the British Broadcasting Corporation's overseas programme. It was first published in January 1941 and already has been reprinted many times. Sir Robert's analysis is "based upon wide scholarship, first hand experience and the conviction of many years." The paper-covered booklet of 56 pages is pocket size and is on sale in almost any bookstore.

## Table of Exchange Rates

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

| | *31st July 1941* | *15th August 1941* |
|---|---|---|
| U.S. Dollars | 10-11% P. | 10-11% P. |
| Sterling | 443-447 | 443-447 |
| Australian Pounds | 358½ | 358½ |
| New Zealand Pounds | 360 | 360 |
| South African Pounds | 443 | 443 |
| British West Indian—Dollars | 9270 | 9270 |
| India—Rupees | 3352 | 3352 |
| Hongkong—Dollars | 2795 | 2799 |
| Straits Settlements—Dollars | 5251 | 5251 |
| *Finland—Finmarks | No quote | No quote |
| Sweden—Kronor | 2639 | 2639 |
| Switzerland—Francs | 2592 | 2576 |

*Inland or blocked finmarks—Free finmarks 2.26c. 30th June 1941

There are no quotations for Italy (lire) or for the following countries under the control of Germany: Belgium (belgas), Denmark (kroner), France (francs), Holland (florins), and Norway (kroner).

*Note:* The above quotations are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies and sundry British Empire—Canadian cents per 100 units.

## An Accounting Problem

A railway company constructs several miles of road from a company's main plant to a branch plant and has a written agreement with the company which stipulates that the railway company shall allow credits against the charge for construction at a rate per car of manufactured products shipped over the new trackage prior to the maturing date of a note which the company gives the railway.

It is apparent from the agreement that the company

must pay the cost of the trackage upon maturing of the note unless a sufficient number of cars have been shipped to liquidate the indebtedness.

The opinions of our readers are solicited as to the proper method of stating the transaction on the balance sheet. It has been customary for the company to treat the transaction as a contingent liability footnote on the balance sheet.

The auditors for the company insist on showing the amount of the note in the balance sheet with a contra debit "Intangible Assets."

Discussion of the auditors' treatment is also requested.

## LEGAL DECISIONS

[EDITOR'S NOTE: The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

### Taxes—Conflict of laws—Succession duty—Situs of shares—Two foreign transfer offices

*(re Blonde et al.)*

Ontario Court of Appeal

Shares in a Michigan company owned by a testator domiciled in Ontario, where the share certificates are found on his death, which are transferable on the books of the company in either Michigan or New York, cannot be held to be property situate in Ontario so as to be subject to succession duty under s. 6(1) of the *Succession Duty Act*, 1934 (Ont.), c. 55. The fact that the shares are transferable at two places is no ground for disregarding both and fixing their situs at a third place. The fact that the testator's executors can transfer the beneficial interest in the shares by endorsement and delivery of the certificates in Ontario does not give the shares a situs in the Province. The share certificates are not specialties so as to constitute *bona notabilia* situate in the place where they are found. (*Per* Masten J.A., dissenting: Inasmuch as the testator in his lifetime, and his executors after his death, could effectively dispose of the beneficial interest in the shares by endorsing and delivering the certificates in Ontario, the shares were situate in Ontario. Moreover, share certificates under

the company's seal are specialties. The existence of transfer offices in two places weakens if it does not destroy the foundation of the rule that shares are situate at the place where they can be transferred.) [1941] 3 D.L.R. 225.

**Taxes—Income War Tax Act—Personal holding and subsidiary corporations—Consolidated return**

*(re Richardson)*

Exchequer Court of Canada

Unless under the provisions of s. 35(3) of the *Income War Tax Act,* R.S.C. 1927, c. 97 (am. 1935, c. 40, s. 13), which authorizes a holding corporation to elect to file a return in which its profit or loss is consolidated with that of its wholly owned subsidiary corporations which carry on the same general class of business—a personal holding corporation cannot file such a consolidated return so as to enable a shareholder therein to claim as a deduction for income tax purposes a loss sustained by a wholly owned subsidiary personal corporation; and moreover it is doubtful whether s. 35(3) is intended to apply to personal corporations, and in this case it is also doubtful whether the subsidiary personal corporation in question carries on the same general class of business as the holding corporation. [1941] 3 D.L.R. 249.

**Taxes—Income accumulating in trust for benefit of unascertained individuals—Whether trustees "a charitable institution."**

*(re Cosman Estate)*

Supreme Court of Canada

A testator by his will directed the accumulation of certain funds in the hands of trustees in Nova Scotia until the happening of a certain event whereupon half of the fund should be paid to trustees in Ireland and half retained by the Nova Scotia trustees; the income from half of each resulting fund should then be used for the benefit of the poor and needy of Nova Scotia and Ireland respectively, whilst the remaining half of each resulting fund should be allowed to accumulate for a long period and then used to establish homes for the needy in Nova Scotia and Ireland respectively, under the direction of a Church dignitary in each place and of others appointed by such dignitaries.

*Held,* the income of the whole of the fund while still accumulating in the hands of the Nova Scotia trustees before the happening of the specified event is "income accumulating in trust for the benefit of unascertained individuals," viz., the poor and needy in Nova Scotia and Ireland, and is therefore taxable under s. 11(2) of the *Income War Tax Act,* R.S.C. 1927, c. 97. The Nova Scotia trustees do not constitute a "charitable institution" within the meaning of s. 4(e) so as to render the income exempt from taxation.—[1941] 3 D.L.R. 224.

(Note: A brief summary of the judgment of the Exchequer Court of Canada in this case was published in the February 1941 issue of THE CANADIAN CHARTERED ACCOUNTANT.)

**Taxes—Edmundston assessment act (N.B.)—Assessment at 7½% of turnover—Discretion to impose tax on rental value**

*(re Rossignol)*

New Brunswick Supreme Court

Section 13(4) of the *Edmundston Assessment Act,* 1937 (N.B.), c. 67, confers a discretionary power on the assessors to impose a tax of 10% of the rental value of a person's business premises where the average value of his stock-in-trade is less than 15% of his sales turnover, and an assessment at 7½% of his annual turnover under s. 13(3) is not thereby invalidated.—[1941] 3 D.L.R. 61.

## PROVINCIAL NEWS

### BRITISH COLUMBIA

In the Final Law examinations held in June 1941 nine candidates were successful. First place was attained by A. P. Gardner and second place by G. F. Dunn. Other successful candidates were—J. S. Agnew, L. B. Boucher, F. Copithorne, F. J. Holden, J. C. Melville, G. M. Miller and D. Wise.

**Annual Meeting** — The members of The Institute of Chartered Accountants of British Columbia held their thirty-sixth annual general meeting at the Hotel Vancouver, Vancouver, B.C., on Friday, 27th June.

Mr. J. Haydn Young, retiring President, occupied the chair and presented his report and the accounts for the financial year ended 31st May 1941. The reports of five committee chairmen were also submitted and the retiring Presi-

dent and members of the Council were sincerely thanked for their services during the past year.

The members approved the new By-Law 48 and Article 8 of the Code of Professional Ethics, particulars of which are included in the Institute's annual report to The Dominion Association of Chartered Accountants and will be published in the year book for 1941-42.

Mr. W. G. Rowe, President of The Dominion Association of Chartered Accountants, gave an address upon the activities of the Executive and various committees of The Dominion Association.

Members elected to serve on the Council for the year ending 31st May 1942 were C. G. Chambers, W. H. Cotter, K. D. Creer, Frederick Field, R. C. Field, R. R. Keay, W. Macintosh, E. C. Mapson, W. G. Rowe, L. R. Sinclair, B. E. Stokes and J. Haydn Young.

At a subsequent meeting of the Council the following were elected officers for the ensuing year: K. D. Creer, President; W. Macintosh, Vice-President; H. Norman Lunn, Secretary-Treasurer.

Votes of appreciation for services rendered were unanimously passed to Austin H. Carr, Secretary-Treasurer of The Dominion Association and to H. Norman Lunn, Secretary-Treasurer of the Institute.

In view of the forthcoming Dominion convention being held in Vancouver, the usual social functions following the annual meeting were not held.

## ONTARIO

**Annual Meeting**—The fifty-eighth annual general meeting of The Institute of Chartered Accountants of Ontario was held at the Royal York Hotel, Toronto, on 27th June at 10 a.m. and was attended by a representative gathering of members from various parts of the province. The President, Mr. W. G. H. Jephcott, in referring to the absence of members who were on active service, said, "The Institute is honoured in the circumstances through their absence. I believe that it is with some justifiable pride that we again

point to the part which our members in many walks of life and phases of activity are playing in the national economy of our Dominion in the second year of the world Armageddon, and even as I have unbounded faith in the ultimate victory of our armed forces over the Nazis, so do I look to the contribution which this profession will make in that period of reconstruction and readjustment which must follow the war."

The report of the Council and the financial statement showed that continued progress had been made during the year. The election of officers for the year 1941-42 had the following results: R. H. Bounsall, K. LeM. Carter, A. G. Edwards, J. F. Gibson, R. R. Grant, H. P. Herington, E. J. Howson, F. C. Hurst, W. G. H. Jephcott, G. S. Jewell, C. G. McConnell, A. R. McMichael, C. A. Patterson, S. G. Richardson and F. S. Vanstone.

At a meeting of the Council held immediately after the annual meeting the following were elected officers for the ensuing year: President, J. F. Gibson; First Vice-President, F. C. Hurst; Second Vice-President, R. R. Grant; and Secretary-Treasurer, E. J. Howson. The three senior officers of the Institute were appointed representatives on the Council of The Dominion Association with the Secretary-Treasurer as an alternative. The Institute auditors for the year are Reginald Campbell and F. R. Stone.

It was again resolved not to hold a supper dance and that the amount usually expended thereon be donated to war charities. Accordingly, a donation of $1,000.00 was voted to the following funds: The British War Victims' Fund, and the Red Cross British Bomb Victims' Fund—$500.00 to each.

A golf tournament was held at the Thornhill Golf Club in the afternoon and a number of the members enjoyed a stag dinner at the club in the evening. The H. Percy Edwards Trophy for low net was won by H. A. Cotnam, and the other prize winners were Arthur Arnold, low gross; D. A. Ampleford, and A. C. Wilson, 1st low net; C. P. Morgan and G. F. L. Gardner, 2nd low net.

**June 1941 Examinations**—The Council of The Institute of Chartered Accountants of Ontario announces the following results of the Final examination held in June last. This

examination was held at that time because of the demand for chartered accountants on account of the war.

*Passed Full Examination*—A. M. Adamson, G. E. Armstrong, A. A. Bailie, F. W. D. Campbell, E. A. Carrothers, S. C. Costigane, E. L. Goodfellow, W. A. Greenman, Harry Heyes, G. B. Hughes, R. L. McCarthy, J. W. Nott, S. L. Orenstein, J. A. Ovens, Mark Perlmutter, R. I. Priddle, M. W. Rashkis, H. C. Rogers, Nathan Stein, G. F. Stiff, J. M. Storey, M. B. Tennant, J. G. Webb and M. W. Wesbrook.

*Granted Supplemental Examination*—The following passed in all but the subjects indicated and have been granted a supplemental examination therein: J. D. Anderson, H. E. Clayton, R. J. J. Dallard and C. V. Maltby (Auditing I and II); M. A. Cunningham, K. H. Dunn, James Gray, G. O. Huggan, R. B. Moran and B. T. Stephenson (Accounting I and III); J. B. Currier (Accounting I and IV); W. E. Butler, E. B. Smith, H. A. Starr, C. R. Welch and B. C. Willis (Accounting II and III); Murray Grossman (Accounting II and IV); J. T. Bowles, F. W. Fredenburg, G. F. Hogarth, G. K. Hutchings, H. I. Robinson and F. W. Woods (Accounting III and IV); S. W. Browne, R. A. Burnes, J. B. Currier, B. T. Stephenson, A. W. Ward and B. C. Willis (Economics).

## QUEBEC

The Society of Chartered Accountants of the Province of Quebec announces the following results of the Final uniform examination of the Provincial Institutes written 2nd to 7th June 1941:

*Passed Full Examination*—Robert Charles Berry, Julius L. Borer, James Arthur Cook, Charles William Gurnham, Abraham Kastner, Alexander Kenneth MacRae, John Williamson Nicol and Albert Paquet.

*Passed Supplemental Examination*—Philip Lucas Clarke, George Ian Craig, Maynard F. Dart, Victor Houghton, E. Saul Leiter, L. Gilbert Marrotte, Kenneth Donald Lunam, Harry L. Rodier and Donald F. Watson.

*Granted Supplemental Examination* — J. Ramsey Fraser, Edwin R. Matthews, J. Leonard O'Donnell and Sidney Steinberg.

John Williamson Nicol obtained highest marks in the Province of Quebec and second highest in the Dominion, and is therefore the winner of the Silver Medal awarded by the Dominion Association and of the First War Memorial Prize awarded by the Quebec Society.

Alexander Kenneth MacRae obtained second highest marks in the Province of Quebec and is the winner of the Second War Memorial Prize awarded by the Quebec Society.

The Society also announces the following results in a Final examination held at L'Ecole des Hautes Etudes Commerciales de Montreal 2nd to 5th June 1941:

*Passed Full Examination*—Lucien Dahme, Rene Gagnon, Jean-Paul Gregoire, Armand Hebert, Andre Leman and Geo.-R. Martin.

*Passed Supplemental Examination*—Rene-F. Grothe, Adjutor Menard and Jean-Paul Talbot.

*Granted Supplemental Examination* — Herve Beauregard and Delphis Clairoux.

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## PERSONALS

Alan J. Cossar, chartered accountant, announces that he has now moved his office to Room 909, 100 Adelaide Street West, Toronto.

James C. Thompson, chartered accountant, announces the formation of James C. Thompson & Co., chartered accountants, 414 St. James Street West, Montreal.

# STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

## NOTES AND COMMENT

The manner in which the problem of joint costs is treated in the representative cost accounting text rather suggests that it is one which is peculiar to a small group of special industries such as the meat packing and chemical industries. It is now being recognized however that while the problem becomes an acute one only in certain fields yet in some degree or other it is present in the entire field of business. Thus any concern which is manufacturing more than a single homogeneous product is certainly producing under conditions of joint cost so far as the expenses of general administration and supervision are concerned, and probably doing so in relation to the expense of providing numerous factory services of one kind and another. The employment of a burden rate for the distribution of factory overhead is therefore in part a method of cutting the Gordian knot of joint costs.

Some years ago (March, 1937) in these notes we expressed the opinion that the *total* cost of each of two or more joint products is, as a matter of scientific fact, not determinable, and that the most the cost accountant can usefully do is to calculate the *direct* cost of each such product. The spread between selling prices and direct costs for all products combined can then be compared with the aggregate of the indirect costs, to determine whether or not production is profitable, at existing prices for the purchase of the raw material and the sale of the products. Another way of putting this same proposition may be quoted from p. 75 of Paton and Littleton, *An Introduction to Corporate Accounting Standards:* "A view which is receiving increasing emphasis in cost circles is that which recommends the restriction of the departmentalizing of charges to those costs which would clearly be eliminated if the particular department were to be lopped off. Under this view, in other words, each department is charged only with the 'inescapable' costs of the class of revenue involved. The difference between departmental revenue and the assigned cost then becomes the 'contribution' of the department to

the common costs of the undertaking and to net income." These authors go on to express the opinion that if for some purpose or another (such as rate regulation) the cost accountant is compelled to produce figures of total cost of each of two or more joint products, it may be expedient for him to base the apportionment of costs on the market values of the several products.

* * *

The inroads made upon the staffs of firms of chartered accountants in the old country (in spite of the existence of a "reserved age" for exemption of accountants from compulsory military service) is seen in the sprouting of advertisements in accountancy magazines of courses of instruction for "substitute staff." Presumably two classes of "supers" are being employed as a result of the present emergency, one the retired accountant who perhaps will benefit from a "refresher course," the other the retired banker, schoolmaster and so forth who in greater or less degree will need a grounding course in bookkeeping, accounting and auditing.

* * *

## PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

### PROBLEM I

### THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

### FINAL EXAMINATION, 1940

#### Accounting III, Question 1 (35 marks)

John Smith died on 1st January 1939. By his will, he left an annuity to his widow of $5,000.00 per year, with the use of his house and furniture during her life. The executors were to invest $50,000.00 for each of his two daughters, Mrs. A. Brown and Miss B. Smith, the income from such specific investments to be paid to them during the lifetime of the widow. Further sums of $3,000.00 each were left to his three grandchildren (the children of Mrs. A. Brown), payable when they attained the age of twenty-one years. All bequests were free of succession duties. Surplus income was to be divided one quarter to the widow, one quarter to each daughter and the remaining quarter to be held in trust and invested until the death of the widow, when it shall be divisible with the rest of the estate among the surviving daughters and grandchildren. No mention is made in the will of remuneration to executors.

The following shows the position of the estate's assets on 31st January 1939, after all succession duties and debts had been paid:—

| | | |
|---|---|---|
| Investments—at probate value | | $150,000.00 |
| Residence | | 10,000.00 |
| Property A | | 10,000.00 |
| Property B (non-revenue bearing) | | 5,000.00 |
| Investments purchased 31st January 1939 re legacy to Mrs. A. Brown | | |
| $20,000.00 Dominion of Canada, 5% bonds | $22,000.00 | |
| $20,000.00 Provincial 4½% bonds | 21,000.00 | |
| $10,000.00 Trading Co., Limited, common shares | 11,000.00 | |
| | | 54,000.00 |
| Investments purchased 31st January 1939 re legacy to Miss B. Smith (chosen by Miss Smith herself from a list supplied) | | |
| $25,000.00 Dominion of Canada, 5% bonds | $27,500.00 | |
| $10,000.00 Power Co., Limited, 7% pref. cum. dividend | 10,350.00 | |
| $15,000.00 Gold Mines Limited common shares | 15,000.00 | |
| | | 52,850.00 |
| Interest accrued on investments purchased | | |
| Dominion of Canada | $ 562.50 | |
| Provincial | 150.00 | |
| | | 712.50 |
| Cash in Bank | | 5,000.00 |
| | | $287,562.50 |

From the books and the executors, the following facts are obtained:—

1. That on 1st March 1939, Miss B. Smith moved to the United States as a permanent resident.

2. Receipts during year:—

| | | | |
|---|---|---|---|
| Investment income on $150,000.00 received subsequent to 1st February 1939 | | | $7,500.00 |
| Rents from property A, subsequent to 1st February 1939 | | | 1,200.00 |
| Feb. | 1. | Power Co. dividend | 350.00 |
| May | 1. | Interest—Dominion bonds | 1,125.00 |
| June | 1. | Interest—Provincial bonds | 450.00 |
| July | 1. | Trading Co. dividend | 1,200.00 |
| Aug. | 1. | Power Co. dividend | 350.00 |
| Sept. | 1. | Gold Mines Limited dividend | 812.50 |
| Nov. | 1. | Interest—Dominion bonds | 1,125.00 |
| Dec. | 1. | Interest—Provincial bonds | 450.00 |
| Dec. | 31. | Interest on loan to executor | 20.00 |

3. Payments during year:—

| | | | |
|---|---|---|---|
| Feb. | 1. | Miss B. Smith re Power Co. dividends | $ 350.00 |
| May | 2. | Miss B. Smith re Dominion bond interest | 625.00 |
| | | Mrs. A. Brown re Dominion bond interest | 500.00 |
| June | 2. | Mrs. A. Brown re Provincial bond interest | 450.00 |
| June | 30. | Mrs. John Smith—Annuity | 5,000.00 |
| | | City taxes on property A | 250.00 |
| | | City taxes on property B | 150.00 |
| | | City taxes on residence | 170.00 |
| | | Loan to executor at 2% | 2,000.00 |
| | | Donation to Red Cross Society | 100.00 |

| | | | |
|---|---|---|---|
| July | 31. | Mrs. A. Brown, on account of legacy to grand-children for their maintenance | 1,000.00 |
| Nov. | 1. | Mrs. A. Brown, on account | 750.00 |
| | | Miss B. Smith, on account | 750.00 |
| Dec. | 1. | Executors, for their remuneration | |
| | | Month of January 1939 | 500.00 |
| | | Balance of year 1939 | 500.00 |

The executors call you in at the end of the year 1939 and they ask you:—

(a) To advise them of any matters which have been dealt with incorrectly.

(b) To prepare cash book, income account and capital account for the year and balance sheet as at 31st December 1939.

## SOLUTION

(1) The executors should be informed that they have dealt incorrectly with the following matters:

(a) The will states that the executors were to invest $50,000.00 each for the two daughters. Consequently, they have overexpended for investments for Mrs. Brown by $4,000.00, and for Miss B. Smith by $2,500.00 ($2,850.00-$350.00). As the investments were over the specified amount, income should be credited with its proportion of the excess income, i.e., in the case of Mrs. Brown, $\frac{4,000}{54,000}$, and in Miss Smith's case, $\frac{2,500}{52,500}$ of the income received in respect of the investments held in trust for them.

(b) It would appear that the following investments are not authorized either by statute or by the will:—

Trading Co. Limited Common
Power Co. Limited 7% Preferred
Gold Mines Limited

The fact that Miss Smith picked the investments would not relieve the trustees of their responsibilities.
These unauthorized investments should be sold and adjustments made so that $50,000.00 in authorized investments is held in trust for each daughter.

(c) As the Power Co. Limited preferred shares were purchased cum dividend, the $350.00 received on 1st February should be credited to the cost thereof rather than be paid to Miss Smith.

(d) The accrued interest on Dominion and provincial bonds should be first recovered before payment is made to Mrs. Brown and Miss Smith.

(e) No deduction for the 5% income tax payable to the Dominion was made before remitting to Miss Smith—a non-resident.

(f) The payment of the annuity to the widow was made before it was due. The first payment should not have been made until the first anniversary of death.

(g) The executor is not entitled to borrow money from the estate unless expressly authorized to do so by the will. The loan is, therefore, not a proper investment and should be immediately repaid. Moreover, the rate of interest payable on this loan should not be so low as 2%. The Executor should pay at least the current market rate and would possibly be charged at a higher rate.

(h) The executors have no power to make donations, and the amount so expended should be refunded by them, unless the consent of the residuary legatees to the donation is obtained.

(i) **The propriety of the payment** to Mrs. Brown on account of the legacy to the grandchildren **should be questioned.** A trustee is entitled to maintain an infant beneficiary out of the income of the trust, but before deciding to do so, he should have regard to what other **income,** if any, is available for the **same purpose.** [A trustee may apply any capital money for the advancement or benefit (which may include maintenance) of any person entitled to the capital up to not more than one-half of that person's presumptive share of the capital, subject to the consent, in writing, of any other persons of full age, who are entitled to any prior or life interest in the fund. An executor is not, as a rule, justified in applying any part of the capital of a legacy for maintenance (*Davies* v. *Austen*) but the Court might, upon application, authorize the application of part of the capital for maintenance, if either the total fund is small, or there are no other means of providing for the support of the child. And the executor might do this upon his own authority, if he does no more than the Court would have directed if it had been resorted to in the first instance. (*Williams, on Executors*)].

(j) An executor is not entitled to any remuneration unless the will so directs under English law, and in Canada, is entitled to only such allowance as may be allowed by the Court, so that the payment to the executor should be held in suspense until approved.

(k) The income from investments due to the daughters should be paid over as received. (Miss Smith should have 5% deducted on all payments and the amount be remitted to the Receiver General).

**Note:**

Referring to (i) above, it will not be necessary for the candidate to present that part of the answer included in the square brackets in order to obtain full marks for this point, the items in bold face type being sufficient.

Referring to (j) above, if the candidate charged $500.00 of the fee to capital and $500.00 to income, mentioning that this treatment would be subject to approval by the Court, his answer would be satisfactory. In the solution, the cash book, income account, capital account and balance sheet would, of course, be amended to conform with this optional treatment.

### INCOME ACCOUNT

| | | | |
|---|---|---|---|
| 1939 | Receipts | | $ 8,720.00 |
| 1939 | Payments | $ 5,420.00 | |
| | Excess Income—Mrs. Brown | | 200.00 |
| | Miss Smith | | 100.00 |
| | Distribution of Income: | | |
| | Mrs. J. Smith ¼ | 900.00 | |
| | Mrs. Brown ¼ | 900.00 | |
| | Miss Smith ¼ | 900.00 | |
| | Trust Estate ¼ | 900.00 | |
| | | $ 9,020.00 | $ 9,020.00 |

## CAPITAL ACCOUNT

| | | | | |
|---|---|---|---|---|
| 1939 | | | | |
| Jan. | 31 | Balance | | $287,562.50 |
| | | Mrs. Brown Trust | $ 50,000.00 | |
| | | Miss Smith Trust | 50,000.00 | |
| | | Grandchildren Trust | 9,000.00 | |
| June | 30 | Taxes | 150.00 | |
| Dec. | 31 | Balance | 178,412.50 | |
| | | | $287,562.50 | $287,562.50 |
| 1940 | | | | |
| Jan. | 1 | Balance | | $178,412.50 |

## MRS. BROWN

| | | | | |
|---|---|---|---|---|
| 1939 | | | | |
| Dec. | 31 | Receipts | | $ 2,700.00 |
| | | Payments | $ 1,700.00 | |
| | | Transfer to Income 4/54 of $2,700.00 | 200.00 | |
| | | Transfer from Income | | 900.00 |
| | | Balance | 1,700.00 | |
| | | | $ 3,600.00 | $ 3,600.00 |
| 1940 | | | | |
| Jan. | 1 | Balance | | $ 1,700.00 |

## MISS SMITH

| | | | | |
|---|---|---|---|---|
| 1939 | | | | |
| Dec. | 31 | Receipts | | $ 2,100.00 |
| | | Receiver General | $ 105.00 | |
| | | Payments | 1,725.00 | |
| | | Transfer to Income—25/525 of $2,100.00 | 100.00 | |
| | | Transfer from Income | | 900.00 |
| | | Receiver General | 45.00 | |
| | | Balance | 1,025.00 | |
| | | | $ 3,000.00 | $ 3,000.00 |
| 1940 | | | | |
| Jan. | 1 | Balance | | $ 1,025.00 |

# ESTATE OF JOHN SMITH

## CASH TRANSACTIONS FOR THE YEAR 1939

| 1939 | CASH RECEIPTS | Mrs. Brown Credit | Miss Smith Credit | Capital Credit | Income Credit | Bank Account |
|---|---|---|---|---|---|---|
| | Cash in Bank | | | $5,000.00 | | $5,000.00 |
| | Investment income | | | | $7,500.00 | 7,500.00 |
| | Rents | | | | 1,200.00 | 1,200.00 |
| Feb. 1 | Power Co. div. | | | 350.00 | | 350.00 |
| May 1 | Dominion bonds | $ 250.00 | $ 296.87 | 562.50 | | 1,125.00 |
| | Rec. General | | 15.63 | | | |
| June 1 | Prov. bonds | 300.00 | | 150.00 | | 450.00 |
| July 1 | Trading Co. | 1,200.00 | | | | 1,200.00 |
| Aug. 1 | Power Co. div. | | 332.50 | | | 350.00 |
| | Rec. General | | 17.50 | | | |
| Sept. 1 | Gold Mines div. | | 771.88 | | | 812.50 |
| | Rec. General | | 40.62 | | | |
| Nov. 1 | Dom. bonds | 500.00 | 593.75 | | | 1,125.00 |
| | Rec. General | | 31.25 | | | |
| Dec. 1 | Prov. bonds | 450.00 | | | | 450.00 |
| 31 | Executors-int. | | | | 20.00 | 20.00 |
| | | | $2,100.00 | | | |
| | Miss Smith | | $1,995.00 | | | |
| | Rec. General | | 105.00 | | | |
| | | $2,700.00 | $2,100.00 | $6,062.50 | $8,720.00 | $19,582.50 |

| 1939 | CASH PAYMENTS | Mrs. Brown Debit | Miss Smith Debit | Capital Debit | Income Debit | Bank Account |
|---|---|---|---|---|---|---|
| Feb. 1 | Miss Smith | | $ 350.00 | | | $ 350.00 |
| May 2 | Miss Smith | | 625.00 | | | 625.00 |
| May 2 | Mrs. Brown | $ 500.00 | | | | 500.00 |
| June 2 | Mrs. Brown | 450.00 | | | | 450.00 |
| June 30 | Mrs. J. Smith | | | | $5,000.00 | 5,000.00 |
| | City Taxes— | | | | | |
| | Property A. | | | | 250.00 | 250.00 |
| | Property B. | | | $ 150.00 | | 150.00 |
| | Residence | | | | 170.00 | 170.00 |
| | Loan to executor | | | 2,000.00 | | 2,000.00 |
| | Donation to Red Cross | | | 100.00 | | 100.00 |
| July 31 | Mrs. A. Brown re Children | | | 1,000.00 | | 1,000.00 |
| Nov. 1 | Mrs. A. Brown | 750.00 | | | | 750.00 |
| | Miss B. Smith | | 750.00 | | | 750.00 |
| Dec. 1 | Executors | | | 1,000.00 | | 1,000.00 |
| | | $1,700.00 | $1,725.00 | $4,250.00 | $5,420.00 | $13,095.00 |

## BALANCE SHEET AS AT 31st DECEMBER 1939

### ASSETS

| | | |
|---|---|---|
| **Cash in Bank**—Income account | $ 3,775.00 | |
| Capital account | 2,712.50 | $ 6,487.50 |
| **Due from Executors** | | |
| Loan | $ 2,000.00 | |
| Donation | 100.00 | |
| Fees | 1,000.00 | 3,100.00 |
| **Investments**—at probate value | | 150,000.00 |
| **Trust Investments**—at cost | | |
| Miss B. Smith | $54,000.00 | |
| Mrs. A. Brown | 52,500.00 | 106,500.00 |
| **Real Estate**—at probate value | | 25,000.00 |
| | | $291,087.50 |

### LIABILITIES

| | | |
|---|---|---|
| **Current**—on Income account | | |
| Receiver General | $ 150.00 | |
| Miss B. Smith | 1,025.00 | |
| Mrs. A. Brown | 1,700.00 | |
| Mrs. J. Smith | 900.00 | $ 3,775.00 |
| **Trust Accounts** | | |
| Miss B. Smith | $50,000.00 | |
| Mrs. A. Brown | 50,000.00 | |
| Grandchildren | 8,000.00 | |
| Trust Estate | 900.00 | 108,900.00 |
| **Capital Account, as per Statement** | | 178,412.50 |
| | | $291,087.50 |

## PROBLEM II
## THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS
### FINAL EXAMINATION, 1940
### Accounting III, Question 2 (10 marks)

Company A has a capital stock of $100,000 and a surplus of $32,000, of which $4,000 was added out of the profits for 1939, which amounted to $10,000. The balance, $6,000, of profits, had been disbursed as dividends. On 1st January 1939, Company B had acquired a 90% interest in Company A at a cost of $125,000, at which amount the investment account is now carried on Company B's books. Company B has a capital stock of $500,000 and a surplus of $200,000. On 1st January 1940, Company C purchases an 80% interest in Company B for $600,000.

What is the amount of the consolidated goodwill on 1st January 1940?

### SOLUTION

| | | | | |
|---|---|---|---|---|
| Investment of Company B in Company A ..... | $125,000 | 90% of Company A's net worth on date of purchase | | |
| | | Capital ....... | $100,000 | |
| | | Surplus ...... | 28,000 | |
| | | 90% of .... | $128,000 | $115,200 |
| | | 72% of Company A's surplus since date of purchase | | |
| | | 72% of ...... | $ 4,000 | 2,880 |
| Investment of Company C in Company B .... | 600,000 | 80% of Company B's net worth | | |
| | | Capital ....... | $500,000 | |
| | | Surplus ...... | 200,000 | |
| | | 80% of ...... | $700,000 | 560,000 |
| | | | | $678,080 |
| | | Goodwill ....... | | 46,920 |
| | $725,000 | | | $725,000 |

An alternative method of solution is as follows:

| | Co. A | Co. B. | Co. C. | Eliminate Co. A. | Eliminate Co. B. | Goodwill |
|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | |
| Capital ........ | $100,000 | ...... | ...... | $90,000 | ...... | ...... |
| Capital ........ | ...... | $500,000 | ...... | ...... | $400,000 | ...... |
| Surplus ........ | 28,000 | ...... | ...... | 25,200 | ...... | ...... |
| Surplus ........ | 4,000 | ...... | (80% of 90%) | ...... | 2,880 | ...... |
| Surplus ........ | ...... | 200,000 | ...... | ...... | 160,000 | ...... |
| **Assets** | | | | | | |
| Investment in A (90%) | | 125,000 | ...... | 90,000 | ...... | ...... |
| | | | | 25,200 | ...... | $ 9,800 |
| Investment in B (80%) | | ...... | $600,000 | ...... | 400,000 | ...... |
| | | | | ...... | 160,000 | ...... |
| | | | | ...... | 2,880 | 37,120 |
| | | | | | | $46,920 |